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HIGHER BOOK-KEEPING
AND ACCOUNTS

HIGHER BOOK-KEEPING AND ACCOUNTS

BY

L. CUTHBERT CROPPER, F.C.A.

SEVENTH EDITION

REVISED BY

F. D. MORRIS, F.C.A.

(OF KNOX, CROPPER & CO.)

AN EXAMINER IN BOOK-KEEPING TO THE ROYAL SOCIETY OF ARTS, ETC.

AND

A. K. FISON, B.A., F.C.A.

(OF KNOX, CROPPER & CO.)

AN EXAMINER IN BOOK-KEEPING, ETC. TO THE ROYAL SOCIETY OF ARTS,
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PREFACE

THE bibliography will forcefully convey to the reader an idea of the wide approval accorded to this text-book. It is therefore only necessary here to indicate the features which distinguish this, the Seventh Edition, from its predecessors.

The main reason for a new edition was of course to conform the text to the provisions of the *Companies Act*, 1948. This has been done, but in addition certain alterations have been made in the subject matter of the book.

The chapter on the " Double Accounts System " has been omitted on the ground that, since the nationalisation of the British Railways, this subject is of little more than historical interest. The short chapter on Banking and Foreign Exchange has also been omitted, partly because the subject is so much bound up with Government regulations and restrictions that it hardly comes now within the normal scope of the accountancy student, and partly because the necessarily temporary nature of many of the restrictions would result in a serious risk that the subject matter, if included, would be liable to become (at least in part) rapidly out of date. On the other hand, in order to keep abreast of modern practice a fresh chapter has been included on Consolidated Accounts, and though, in the limited space available, it has been possible to deal only with the general outline of the subject and the more important of its principles, yet it is hoped that what has been included will be sufficient for the purpose of the students for whom this work is primarily written.

F. D. MORRIS.
A. K. FISON.

October, 1951.

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CONTENTS

PAGE
PREFACE v
CHAPTER I. SINGLE ENTRY 1
II. SELF-BALANCING LEDGERS 7
III. TRADING, MANUFACTURING, AND PROFIT AND LOSS ACCOUNTS 12
IV. RECEIPTS AND PAYMENTS ACCOUNTS. INCOME AND EXPENDITURE ACCOUNTS. REVENUE ACCOUNTS 71
V. THE BALANCE SHEET 79
VI. PARTNERSHIP—I. LEGAL 119
VII. PARTNERSHIP—II. PARTNERSHIP ACCOUNTS . 142
VIII. CONSIGNMENT ACCOUNTS. JOINT VENTURE ACCOUNTS 245
IX. LIMITED COMPANIES 261
X. LIMITED COMPANIES, STATISTICAL RECORDS, ETC. 319
XI. LIMITED COMPANIES, COMPANY ACCOUNTANCY . 350
XII. LIMITED COMPANIES, COMPANY ACCOUNTANCY, *contd.* 440
XIII. AN INTRODUCTION TO CONSOLIDATED ACCOUNTS. 526
XIV. ✓ DEPARTMENTAL AND BRANCH ACCOUNTS. FOREIGN BRANCH ACCOUNTS 579
XV. ✓ STORE-KEEPING AND COST ACCOUNTS . . 643
→ XVI. HIRE-PURCHASE ACCOUNTS 671
XVII. ROYALTY ACCOUNTS 686
XVIII. ✓ INSOLVENCY 691
XIX. ✓ ASSURANCE ACCOUNTS 729
XX. BANK BOOK-KEEPING 744
XXI. BILLS OF EXCHANGE. CHEQUES. PROMISSORY NOTES 763
INDEX 794

CHAPTER I

SINGLE ENTRY

THE advantages of Double Entry and the disadvantages of Single Entry book-keeping have been dealt with in the elementary text-books, and need not be discussed here.

Definition.—The term " Single Entry " signifies that the method, or lack of method, employed in recording the transactions of a business, fails in some essential to deal with the two-fold aspect of every transaction; in other words, that the double-entry maxim " every debit must have its credit " is ignored. Single-entry book-keeping is merely defective book-keeping. Pure single entry is seldom found in practice; at the very least a Cash Book will be kept.

A typical set of single-entry books usually comprises (*a*) Ledger for keeping the personal accounts of debtors and creditors; (*b*) Sales Book, the details being posted to customers' personal accounts. If no actual book is kept the sales are entered direct from the invoices. No posting is made of sales totals. (*c*) Single-column Cash Book. Items relating to personal accounts are posted, but no postings are made to nominal accounts. (*d*) Creditors' accounts are posted from a waste book, no Purchases Book being kept; (*e*) Discounts allowed and received are entered direct in the personal ledger accounts, no other records being made. To some extent, therefore, single entry is a composite method. But it provides no check ensuring accuracy, and no classified information, both of which are essential to a scientific system of book-keeping. The trader's financial position can be ascertained only by means of a Statement of Affairs.

Ascertaining Profits under Single Entry.—If no books at all were kept, it would still be possible, theoretically, to ascertain the profit for a particular period by calculating the increase in the net value of the assets at the end of the period over the net value of the assets at the beginning of the period, adjustments being made for any amounts paid in or withdrawn by the proprietor during the period. If we could assume that the assets and liabilities were accurately recorded, both at the beginning and the end of the period, then the resulting profit or loss so ascertained would be the same as that shown by a Profit and Loss Account prepared from books kept on double-entry principles. But no details as to how the profit was made, or what the expenses were, would be available, and comparisons with previous periods would be impossible. Apart from these grave defects, it would be found in practice that the data necessary for the preparation of an accurate inventory of assets and liabilities at any date would not be available by such loose methods.

Conversion into Double Entry.—The most satisfactory way of preparing accounts from single-entry books is to instal a double-entry system. A Statement of Affairs prepared at the date of installation would provide the basis for the opening Journal entries; and it would also determine the profit for the *past* period, if the capital at the beginning of that period were known.

Illustration.—J. Young commenced business on January 1, 19..., with a cash capital of £1,000, with which he opened a business banking account. He kept a personal ledger in which he recorded all transactions with customers and wholesale houses. All payments were made by cheque and all receipts banked. At December 31, 19..., he found that he owed £550, and had owing to him £1,400. His Stock, valued at cost price, was £350, and his Bank Balance was £250. Other assets valued at cost were: Fixtures, £150; Motor Lorry, £500; Rent paid in advance, £50. He had drawn regularly £5 per week during the year, but owing to difficulty in collecting book debts he had to pay in an additional £300 capital during December.

(1) Calculate his profit for the year, writing off 8% per annum on the fixtures and 20% per annum on the motor lorry. Interest on opening Capital to be computed at 5%.

(2) Prepare a "Statement of Affairs" as at December 31, 19..., with a view to opening a set of books as from the following day.

J. Young.

STATEMENT OF PROFIT, DECEMBER 31, 19...

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Creditors . .				550	0	0	Fixtures, at cost .	150	0	0			
Capital as at Jan. 1 .	1,000	0	0				*Less* Depreciation	12	0	0	138	0	0
Add cash paid in .	300	0	0	1,300	0	0	Motor Lorry, at cost	500	0	0			
							Less Depreciation .	100	0	0	400	0	0
				1,850	0	0	Payments in advance				50	0	0
Balance carried down				998	0	0	Stock . . .				350	0	0
							Debtors . .				1,400	0	0
							Cash at Bank .				250	0	0
							Drawings . .				260	0	0
				£2,848	0	0					£2,848	0	0
Interest on Capital .				50	0	0	Balance brought down				998	0	0
Net Profit . .				948	0	0							
				£998	0	0					£998	0	0

The items in the Statement of Affairs can now be journalised and posted to a Private Ledger. The cash balance will be the first entry in the Cash Book. The existing Sales and Bought Ledger balances will be agreed with the schedules, and the totals of the schedules with those in the Statement. Subsidiary books, such as Sales Book, Purchases Book, Returns Book, Petty Cash Book, will be brought into being, and instructions be given that adequate records of all transactions shall be kept, and that no entries shall be made in the Ledgers except by posting from a book of original entry.

J. Young.

STATEMENT OF AFFAIRS, DECEMBER 31, 19...

LIABILITIES.	£ s. d.	£ s. d.	ASSETS.	£ s. d.	£ s. d.
Creditors		550 0 0	Fixtures		138 0 0
Capital Account as at Jan. 1	1,000 0 0		Motor Lorry		400 0 0
Add Cash paid in	300 0 0		Payments in advance—Rent		50 0 0
Add Interest on Capital	50 0 0		Stock		350 0 0
Add Net Profit	948 0 0		Debtors		1,400 0 0
	2,298 0 0		Cash		250 0 0
Less Drawings	260 0 0	2,038 0 0			
		£2,588 0 0			£2,588 0 0

Conversion by Completion of Double Entry.—In some cases it will be possible to prepare an approximately correct Profit and Loss Account by carrying through the double entry in detail, as, for example, where a Cash Book has been correctly posted to the Sales and Bought Ledgers; Sales and Purchases Books have been kept; Discount has been recorded, and Returns and Allowances have been entered in special books. It will then be necessary to open Nominal Accounts; complete the postings of expense accounts, etc., from the Cash Book; and record the impersonal aspect of the transactions with debtors and creditors by totalling the Sales and Purchases Books, crediting a Sales Account with the sales and debiting a Purchases Account with the purchases. Generally, however, it will be impracticable to complete the double entry in detail, and the figures for sales, purchases, expense items, etc., will have to be found by analysis and total accounts. The accuracy of the accounts will, of course, depend upon the accuracy of the original records. Where, *e.g.* cash receipts are not banked intact, but partially used for making petty cash and other payments, the completeness of the records will largely depend on the tenacity of the proprietor's memory. Where no Sales and Purchases Books have been kept, the sales, purchases, returns, etc., can be ascertained by analysing the Personal Ledgers, or by summarising the duplicate copy sales, invoices, etc. When accounts have been raised for Cash, Total Debtors, and Total Sales, and the double entry has been completed, a Trial Balance can be extracted, adjustments made, and accounts prepared in the usual way.

Illustration.—J. Young (see previous illustration) desires a Trading and Profit and Loss Account for the year ended December 31, 19..., and a Balance Sheet as at that date for submission to the Inspector of Taxes. With the exception of the Personal Ledger (entered up on the "slip" system from invoices, credit notes, counterfoil cheques, etc.) and the Bank Pass Book, he has kept no books, except a Petty Cash Book.

Since all cash received is banked and all payments are made by cheque, the Pass Book will serve for the analysis of cash; and an analysis of the Personal Ledger will give details of sales, purchases, etc. Loose sheets ruled with columns, each appropriately headed, will be used for the analysis.

The following are the results of the analysis:—

ANALYSIS OF CASH (BANK) BOOK.

Receipts.	£	s.	d.	£	s.	d.	Payments.	£	s.	d.	£	s.	d.
Capital paid in Jan. 1				1,000	0	0	Purchase of Fixtures .				150	0	0
Additional Capital .				300	0	0	Purchase of Lorry .				500	0	0
Received from Debtors				3,080	0	0	Rent . . .				250	0	0
							Drawings . . .				260	0	0
							Wages . . .				300	0	0
							Trade Expenses (detailed) . .				670	0	0
							Petty Cash . .				10	0	0
							Paid to Creditors .				1,990	0	0
							Balance, Dec. 31 .				250	0	0
				£4,380	0	0					£4,380	0	0

ANALYSIS OF SALES LEDGER ACCOUNTS.

Debits.	£	s.	d.	£	s.	d.	Credits.	£	s.	d.	£	s.	d.
Sales . . .				4,600	0	0	Cash received . .				3,080	0	0
							Discounts allowed .				30	0	0
							Returns . . .				50	0	0
							Contras (Bought Ledger) . . .				40	0	0
							Balances, Dec. 31 .				1,400	0	0
				£4,600	0	0					£4,600	0	0

ANALYSIS OF PURCHASES LEDGER ACCOUNTS.

Debits.	£	s.	d.	£	s.	d.	Credits.	£	s.	d.	£	s.	d.
Cash paid . .				1,990	0	0	Purchases . .				2,610	0	0
Discount received .				10	0	0							
Returns . . .				20	0	0							
Contras (Sales Ledger)				40	0	0							
Balances, Dec. 31 .				550	0	0							
				£2,610	0	0					£2,610	0	0

Accounts should be opened for Cash, Total Debtors, Total Creditors, Sales, Purchases, etc., and the above results journalised and posted. A Trial Balance will then result as follows:—

J. Young.

TRIAL BALANCE, DECEMBER 31, 19...

	Dr. £	s.	d.	Cr. £	s.	d.
J. Young, Capital Account				1,300	0	0
Drawings	260	0	0			
Fixtures	150	0	0			
Motor Lorry	500	0	0			
Cash at Bank	250	0	0			
Debtors	1,400	0	0			
Creditors				550	0	0
Sales				4,600	0	0
Sales Returns	50	0	0			
Purchases	2,610	0	0			
Purchases Returns				20	0	0
Discount allowed	30	0	0			
Discount received				10	0	0
Rent	250	0	0			
Wages	300	0	0			
Trade Expenses (detailed)	670	0	0			
Petty Expenses (Petty Cash)	10	0	0			
	£6,480	0	0	£6,480	0	0

J. Young.

TRADING AND PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d. Cr.
To Purchases (less Returns)				2,590	0	0	By Sales (less Returns)				4,550	0	0
,, Wages				300	0	0	,, Stock				350	0	0
,, Balance carried down being gross profit				2,010	0	0							
				£4,900	0	0					£4,900	0	0
To Rent				200	0	0	By Balance brought down				2,010	0	0
,, Trade Expenses				670	0	0							
,, Sundry Expenses				10	0	0							
,, Discount				20	0	0							
,, Depreciation—													
Fixtures	12	0	0										
Motor Lorry	100	0	0										
				112	0	0							
,, Interest on Capital				50	0	0							
,, Net Profit				948	0	0							
				£2,010	0	0					£2,010	0	0

The Balance Sheet will, of course, be the same as in the previous illustration.

EXAMINATION QUESTIONS.

1. Name some of the defects of single-entry book-keeping. (*National Union Teachers.*)

2. In a firm where nothing beyond a Cash Book has been kept and stock taken, you are required to prepare a Balance Sheet, Trading, and Profit and Loss Accounts. Describe your methods. (*Incorporated Accountants.*)

3. The books of a business have been kept by single entry. They are made up to a date, stock has been taken and valued, and it is desired to convert them into double entry. Explain how this is to be done. (*Chartered Secretaries*).

4. A retail trader had not kept proper books of account, but from the following details you are required to ascertain the profit or loss for the year ended December 31, 19..., and also to prepare Statement of Affairs at that date:—

	Jan. 1, 19... £	Dec. 31, 19... £
Stock-in-trade	1,670	1,850
Sundry Creditors	1,540	1,400
Sundry Debtors	1,120	1,050
Cash in hand	25	120
Bank Overdraft	2,020	1,940
Bills Receivable	1,505	1,420
Fixtures, Fittings, etc.	150	150
Motor Van	190	190

The drawings during the year amounted to £260. Depreciate Fixtures, etc., by 10%, write £30 off Motor Van. As regards the Debtors, it is ascertained that £50 is irrecoverable and a further provision of 5% should be made. Also provide £70 in respect of Bills Receivable.

5. You are instructed by a client to convert his single-entry system into one of double entry. How would you proceed? Give entry or entries based on the following statement of Assets and Liabilities:—

LIABILITIES.	£	s.	d.	ASSETS.	£	s.	d.
Sundry Creditors	2,146	9	2	Sundry Debtors	3,596	7	2
Loans	500	0	0	Cash	561	9	2
Bills Payable	1,685	4	9	Stock	1,924	2	8
Bank Loan	500	0	0	Furniture	187	0	0
				Premises	2,000	0	0

(*Chartered Accountants.*)

6. Robert Webber keeps his books by the single entry method. His financial position on January 1 was as follows:—

Cash in hand, £12 10*s.*; Stock-in-Trade, £642 15*s.*; Fixtures and Fittings, £89; Cash at Bank, £153; Sundry Debtors, £421 10*s.*; Machinery and Plant, £981; Sundry Creditors, £1,209 15*s.*

During the year Robert Webber withdrew from the business, for private purposes, the sum of £480.

On December 31, Webber's financial position was as follows:—

Machinery and Plant, £1,350 10*s.*; Fixtures and Fittings, £80 10*s.*; Sundry Debtors, £732; Stock-in-Trade, £950 10*s.*; Cash in hand, £15; Bank Overdraft, £500; Sundry Creditors, £1,400 10*s.*

From the above particulars, prepare a Statement showing the profit made by Webber for the year ended December 31. When preparing this statement, no depreciation need be written off any of the assets, and no provision for Bad and Doubtful Debts is necessary. (*London Chamber Commerce.*)

7. You are instructed by T. Jones, who keeps his books by single entry, to prepare a Profit and Loss Account of his business for the year ended September 30, 1951, together with a Balance Sheet as on that date.

Upon analysing the Cash Book for the year, you find the following, viz.:—

Bank Overdraft at October 1, 1950, £800; Interest on above and Bank Charges, £15; T. Jones's Drawings, £400; Manager's Salary, £200; Salaries and Wages, £1,500; Other Business Expenses, £1,585; Paid to Trade Creditors, £3,000; Balance at Bankers, September 30, 1951, £485; Balance in hands of Cashier, September 30, 1951, £15; Received from Trade Debtors, £5,000; Received from Cash Sales, £3,000.

T. Jones's Capital at October 1, 1950, was £7,000.

His Stock on hand on October 1, 1950, was £1,800, and on September 30, 1951, £2,044; his Creditors on October 1, 1950, £1,600, and on September 30, 1951, £1,100; his Debtors on October 1, 1950, £4,400, and on September 30, 1951, £6,000; his Furniture on October 1, 1950, £200, and on September 30, 1951, £200; his Business Premises on October 1, 1950, £3,000, and on September 30, 1951, £3,000.

You are to allow 5% interest on the balance of Capital at October 1, 1950, to provide £300 for Doubtful Debts, and to charge 5% Depreciation on Business Premises and Furniture.

In addition to the £200 salary already paid to the manager, he is entitled to a commission of 5% upon the net profits, after charging such salary and commission. Make provision for this commission, and prepare the accounts as instructed.

CHAPTER II

SELF-BALANCING LEDGERS

Definition.—In the usual course, as the student is aware, the compensating double entry for a ledger posting is contained in some subsidiary book, *e.g.* in a personal ledger account, goods debited are offset by a compensating credit in the Sales Journal, and cash credited by a debit in the Cash Book, and so on. The term self-balancing ledger, on the other hand, expresses the fact that the double entry has been completed *within the ledger itself.* The obvious corollary to this procedure is that the extraction of all the balances from that particular ledger will result in a Trial Balance proving the arithmetical accuracy of the posting of the ledger at any chosen date.

Procedure.—To achieve the result indicated above, every debit appearing in the accounts in a particular ledger is duplicated by a credit, and every credit by a debit, in a *Control Account,* usually kept at the end of the ledger. The Control Account thus contains a summary, in totals, of all the detailed debits and credits appearing in the individual accounts in the ledger. It will be clear, therefore, that the balance of the Control Account should be equal, and opposite, to the net difference between all the other balances.

In addition to proving the arithmetical accuracy of the postings, the Control Account is also useful, inasmuch as it enables the total of the balances contained in a ledger to be quickly ascertained without the labour of extracting all the individual balances. In other words, it readily shows the total debtors and creditors on that particular ledger at any desired date.

The system described is usually adopted where a business has more than one Sales or Bought Ledger. In cases where the ledgers are numerous, the search for a "difference in the books" may well prove long and tedious. If the ledgers are "self-balancing," the error can be localised in the particular ledger which is at fault, and much time is thereby saved.

The system is also frequently used in cases where the Private Ledger is written up periodically by one of the partners, or the firm's accountants, and it is desired to extract a Trial Balance without disclosing the contents of the Private Ledger to the office staff. A figure can be supplied for incorporation in the general Trial Balance representing the net result of all the balances contained in the Private Ledger.

The principle involved in these accounts is identical with tha employed in "Total Debtors" or "Total Creditors" Accounts, which are operated as follows:—

Assume a business with one Sales Ledger and one Bought Ledger By means of analysis columns in the Cash Book, the total cash poste to the debit, or credit, of the individual personal accounts in the Bough

TRANSFER JOURNAL.

Particulars.	Folio.	Debits.					Credits.					Folio.
		Sales Ledgers.			Bought Ledgers.		Sales Ledgers.			Bought Ledgers.		
		A–K.	L–R.	S–Z.	A–M.	N–Z.	A–K.	L–R.	S–Z.	A–M.	N–Z.	
		£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	
Robinson, Contra . .	R2					20 0 0		20 0 0				R7
Steinbaum, changed name to Brown . .	B6	50 0 0							50 0 0			S3

and Sales Ledgers can be conveniently collected and posted in periodical *totals* to the debit or credit of the "Total Accounts." Thus cash received from customers would be posted *in detail* to the credit of their personal accounts in the Sales Ledger, and, at the end of the month, quarter, or other period, the Sales Ledger column in the Cash Book would be posted *in total* to the "Sales Ledger Total Account," or "Total Debtors' Account."

Discount, Sales, Purchases, Returns, etc., would be similarly treated by the provision of analysis columns where necessary. Any items posted from the Journal, such as bad debts, contras, etc., would also be dealt with twice, viz. once in the Sales or Bought Ledger (Personal Account), and once in the Private Ledger (Total Account). Thus the Total Debtors' Account would contain, *in total*, all the items debited or credited *in detail* in the Sales Ledger, and in extracting a Trial Balance the figure on the Total Debtors' Account would be included. The accuracy of the Sales Ledger balance would be proved by its agreement with the Total Debtors' Account balance.

This method involves what may be termed "triple entry," since cash received, for example, is credited to the personal account of the debtor, debited in the Cash Book, and also credited in the Total Debtors' Account. It may be that it was the desire to complete the double entry, even though it involved "quadruple entry," that led to the raising in the Subsidiary Ledger of a Control Account similar to the latter account in that it contained the same items but on the opposite sides.

Construction of Control Accounts.—Control Accounts are raised in the following manner:—

The Purchase and Sales Journals, other subsidiary books, and the Cash Books are posted in detail to the Sales or Bought Ledgers in the usual way. Periodically (*e.g.* every six months) these subsidiary books are analysed so as to show the total debits and credits posted to each individual Sales or Bought Ledger. The various totals of the items debited to any Sales or Bought Ledger are then credited to the Control Account contained in that ledger, and are debited to the Control Account in the General (or Private) Ledger. For example, the entries in the Sales Journal will be posted in detail to the personal accounts in the Sales Ledger, and the total will be credited to the Sales Account in the General Ledger. This total will then be journalised as follows:—

Sales Ledger Control Account. Dr.
(the account in the General Ledger).
To General Ledger Control Account
(the account in the Sales Ledger).
For credit sales for the period.

The totals of all the subsidiary books will be similarly treated, and it is essential that all items must first pass through a book of original entry. But if all the subsidiary books, and the Cash Book, are provided with analysis columns, as they should be, the periodical analysis will not, of course, be necessary. Transfers between different Sales or Bought Ledgers must first be recorded in a Transfer Journal ruled as shown on p. 8 (assuming that three Sales Ledgers and two Bought Ledgers are employed).

It is not considered necessary to show rulings of the other subsidiary books with analysis columns, since these take the ordinary form, with analysis columns added for the several ledgers to which the detailed items are posted.

Alternative Methods :—

(*a*) The items in each book of original entry may be analysed. This involves some method of distinguishing the items posted to the various ledgers. If, say, there are three Sales Ledgers, they could be allotted code letters, *e.g.* A, B, and C. In posting to the ledgers, the clerk would insert the code letter as well as the folio of the account to which the item was posted. Or, when checking the postings, different-coloured inks could be used for the various ledgers, thus facilitating periodical analysis.

(*b*) Separate books of original entry and Cash Books can be used for each ledger. This is a further extension of the analysis column, or tabular system. Thus, all cash received from customers in the A Sales Ledger would be entered in the A Sales Ledger Receipts Cash Book, all sales to A Ledger customers in the A Sales Journal, etc.

(*c*) Where posting is effected by machine, the total of one batch of postings made to one set of Ledger cards, obtained from the strip, is printed on the control card. There are several variations of this method, which is, perhaps, the only practicable one where the personal ledgers are very numerous, *e.g.* 100 or more, as there sometimes are.

Illustration.—The following is an example of a Sales Ledger Control Account as appearing in the General Ledger, and the General Ledger Control Account as kept in the Sales Ledger.

SALES LEDGER CONTROL ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Jan. 1	To Balance brought down . .	6,216	10	7	19... Jan. 1	By Balance brought down . .	43	6	8
June 30	To Sales . .	12,470	3	4	June 30	By Cash . .	11,760	2	1
" 30	" Cash . .	17	2	2	" 30	" Discount . .	211	3	0
" 30	" Balance carried down . .	50	4	6	" 30	" Bills Receivable	70	0	0
					" 30	" Returns . .	196	0	10
					" 30	" Contras . .	22	0	0
					" 30	" Bad Debts .	15	2	6
					" 30	" Balance carried down . .	6,436	5	6
		£18,754	0	7			£18,754	0	7
19... July 1	To Balance brought down . .	6,436	5	6	19... July 1	By Balance brought down . .	50	4	6

GENERAL LEDGER CONTROL ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Jan. 1	To Balance brought down . .	43	6	8	19... Jan. 1	By Balance brought down . .	6,216	10	7
June 30	To Cash . .	11,760	2	1	June 30	By Sales . .	12,470	3	4
" 30	" Discount . .	211	3	0	" 30	" Cash . .	17	2	2
" 30	" Bills Receivable	70	0	0	" 30	" Balance carried down . .	50	4	6
" 30	" Returns . .	196	0	10					
" 30	" Contras . .	22	0	0					
" 30	" Bad Debts .	15	2	6					
" 30	" Balance carried down . .	6,436	5	6					
		£18,754	0	7			£18,754	0	7
19... July 1	To Balance brought down . .	50	4	6	19... July 1	By Balance brought down . .	6,436	5	6

The Control Accounts described in this chapter were at one time known as "Adjustment Accounts," but the expression "Adjustment Account" used in this connection is now practically obsolete.

EXAMINATION QUESTIONS.

1. From the following particulars prepare the Bought Ledger Control Account as at March 31, 19..., as it should appear in the General Ledger, and bring down the balance:—

March 1, Total Creditors' Balance, £6,261 10*s.* 6*d.* March 31, Purchases, £17,767 14*s.* 4*d.*; Discounts Received, £133 10*s.* 7*d.*; Transfer to Credit of Sales Ledger Account, £76 5*s.* 9*d.*; Bills Payable, £400; Returns, Outwards, £12 10*s.* 4*d.*; Cash Paid, £15,534 11*s.* 2*d.*

2. From the following particulars prepare the Sales Ledger Control Account as it will appear in the General Ledger for the month ended May 31, 19... :—

May 1, Balances, £5,000; Sales, £38,000; Returns Inwards, £150; Cash Received, £36,850; Bills Receivable, £2,000; Bad Debts, £60; Allowances made to Customers, £10; Bills Receivable, dishonoured, £140; Contra Accounts in Bought Ledger transferred, £370. (*Institute of Book-keepers.*)

3. A limited company has in operation a system of sectional balancing in regard to its Sales Ledgers, five in number, as a whole.

You are requested to advise as to any changes necessary or desirable in the accounting system which will, by analysis of the transactions, enable each of these ledgers to be separately balanced. Give your advice accordingly. (*Chartered Accountants.*)

4. From the following particulars prepare the General Ledger Control Account in the Sales Ledger; as at September 30, 19..., and bring down the balance :—

Sales, £17,000; Bills Receivable, £60; Returns, £195; Bad Debts, £75; Dishonoured Bill, £860; Cash Received, £13,020; Discounts, £40; Transfers from Bought Ledger Contra Accounts, £1,970; Opening Debtors, £1,140.

5. From the following particulars write up the Bought Ledger of G. Rosser, and agree the list of balances as on July 31, 19..., by preparing a Bought Ledger Control Account :—

Credit Balances, July 1, 19... : J. Smithson, £84 17*s.* 2*d.*; A. Robinson, £193 6*s.* 8*d.*; D. Dickinson, £14 11*s.* 7*d.*; T. Johnson, £72. Debit Balance, July 1, 19...: G. Williamson, £15 10*s.*

19... July 2 : Purchased goods from A. Robinson, £124 5*s.* 9*d.* July 3 : Purchased goods from T. Johnson, £57 4*s.* 6*d.*; Received cash from G. Williamson for returns, £15 10*s.* July 5 : Paid J. Smithson, £82 14*s.* 9*d.*; Discount allowed by him, £2 2*s.* 5*d.*; Goods returned to T. Johnson, £27 11*s.* July 6 : Purchased goods from D. Dickinson, £185. July 9 : Accepted D. Dickinson's draft at three months, £150; Paid him, £49 11*s.* 7*d.* July 12 : Paid A. Robinson on account, £96; Discount allowed by him, £4; Paid T. Johnson, £101 13*s.* 6*d.* July 16 : Purchased goods from T. Johnson, £88 6*s.* 5*d.*; Purchased goods from D. Dickinson, £217 4*s.* 11*d.* July 25 : Paid D. Dickinson on account, £57 4*s.* 11*d.* July 31 : Purchased goods from A. Robinson, £43 8*s.* 2*d.*; Returned goods to D. Dickinson, £13 13*s.* 8*d.* (*Chartered Accountants.*)

6. From the following particulars prepare the Sold Ledger Control Account in the General Ledger for the month ended July 31, 19... :—

SOLD LEDGER.—July 1, 19..., Debit Balances, £3,000; Sales, £32,000; Returns Inwards, £120; Cash Received, £26,930; Bills Receivable, £2,000; Bad Debts, £180; Bills Receivable dishonoured, £150; Discount allowed to Customers, £60; Contra Accounts in Bought Ledger transferred, £400. (*Institute of Book-keepers.*)

CHAPTER III

TRADING, MANUFACTURING, AND PROFIT AND LOSS ACCOUNTS

I. TRADING AND MANUFACTURING ACCOUNTS.

As the student is aware, when an agreed Trial Balance has been extracted from a set of books at the close of a financial period, the next step is to ascertain the trading results achieved. Occasionally, this is done by preparing a single Profit and Loss Account, but more frequently by dividing the account into two or more sections in order to show: (*a*) the *gross* profit or earnings, and (*b*) the real or *net* profit for the period.

Frequently, a third section is added which shows how the net profit for the period has been appropriated. It is essential in a manufacturing business, if an efficient check upon the manufacturing process is to be maintained, to show the gross profit earned by manufacture.

Construction.—Answers to examination questions called for the preparation of a set of accounts from the ledger balances and information given always reveal differing figures of gross profit; and it must be admitted that in the commercial world also scant uniformity is observable in the apportionment of the various charges as between gross and net profit. In the absence of definite instructions, and in view of the debatable points in this connection, the student will be wise to confine his Trading or Manufacturing Account to those items which directly affect the prime cost of purchasing or producing the articles sold, and to deal with all selling, distribution, and overhead charges in the Profit and Loss Account.

By *Prime Cost* in this connection is meant:—

(*a*) In a non-manufacturing concern, the balance of an account wherein, on the debit side, appears: (*a*) initial stock, (*b*) net purchases, *i.e. less* returns, (*c*) warehouse wages and expenses, (*d*) carriage inwards; and, on the credit side: (*e*) sales (net) and (*f*) final stock. Items which do not vary directly with the sales should be excluded. An account prepared on these lines will show the ratio which the gross earnings bear to sales.

(*b*) In a manufacturing concern, the account should include, on the debit side: (*a*) initial stock and work in progress, (*b*) raw materials purchased (net), (*c*) factory wages and expenses and factory manager's salary, (*d*) carriage inwards, (*e*) factory power, lighting, heating, rent, and rates; and, on the credit side: (*f*) sales (net) and (*g*) final stock and work in progress.

Where the information given in an examination question indicates that other charges are divisible between manufacture and distribution, suitable apportionments must, of course, be made, as explained on p. 25.

Basis Must be Consistent.—The most important information furnished by a series of Trading or Manufacturing Accounts is the ratio of gross profit between period and period. It is therefore *essential* that the account should be constructed upon a consistent plan, otherwise comparisons will be valueless. In the absence of exceptional circumstances the ratio of gross profit should not vary, except within narrow limits. If wide fluctuations in the ratio of gross profit to turnover should occur, immediate investigation should follow, since such fluctuations may arise from defalcation, pilfering, faulty buying, or inaccurate stock valuations.

Non-Manufacturing Concerns.—Where all goods are purchased ready for sale, and no manufacturing is done, the construction of the Trading Account usually follows the simple lines indicated above, and illustrated in the solution on p. 18. This form of account, if consistently adhered to, will, in most cases, enable the necessary comparisons to be made, more particularly the ratio between gross profit and sales. It is true that the Trial Balance will probably contain items that do not enter into the cost of the goods, *e.g.* depreciation. Such charges do not, however, move in sympathy with the turnover, and, unless he is instructed to the contrary, the examination candidate will be wise to confine them to the Profit and Loss Account.

Manufacturing Concerns.—In a manufacturing business the Working or Manufacturing Account usually contains much more detail than the Trading Account dealt with above. The actual cost of the goods sold by a merchant is fixed by his invoices, but the manufacturer can ascertain the cost of his goods only by careful accounting.

(*a*) In the majority of cases manufacturers prepare a combined Manufacturing and Trading Account. This deals with the costs of manufacture and the resulting sales. But accounts in this form fail to show the actual manufacturing profit.

(*b*) In other cases a Manufacturing Account is prepared which is strictly confined to ascertaining the actual cost of the goods made, without reference to the current market price of similar goods. Then the account shows neither profit nor loss, and the balance, representing cost, is transferred to a Trading Account which includes sales and the relative distribution costs. The balance of this account is then carried to a Profit and Loss Account in which the net profit for the period is determined.

(*c*) In yet other cases the Manufacturing Account is charged with all costs of production on the usual lines, and is credited, at current market values, with the goods produced. The resulting balance shows the manufacturer's factory profit or loss on the basis of current market prices. The goods made are debited to the Sales Department at the current market price just as though they had been purchased from outside sources. The results shown by both the manufacturing and sales departments are finally transferred to the Profit and Loss Account.

Blankshire Blast Furnaces, Limited.

MANUFACTURING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	£	s.	d.	Cr.	£	s.	d.	£	s.	d.
To Materials consumed*:—							By Sales:—						
Coal (including carriage)	6,420	10	2				Slag (net)	4,604	1	2			
Coke (including carriage)	17,924	1	1				Sand	141	11	10	4,745	13	0
Limestone	1,621	0	4				„ Wagon Hire (sublet)				321	0	10
Ironstone	6,352	8	9				„ Pig Iron produced, transferred to Trading Account (cost per ton, 37s. 5½d.)				34,457	7	7
Sundry Materials	281	4	6	32,599	4	10							
„ Manufacturing Wages				5,762	12	6							
„ Salary, Works Manager				1,000	0	0							
„ Land Damages and Compensation				162	4	1							
				£39,524	1	5					£39,524	1	5

TRADING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	Cr.	£	s.	d.	£	s.	d.
To Stock of Pig Iron at this date (cost per ton, 35s. 6¼d.)	8,122	10	0	By Sale of Pig Iron	50,851	14	6			
				Less Short Weight claims	841	10	2	50,010	4	4
„ Cost of Pig Iron produced as per Manufacturing Account	34,457	7	7	„ Pig Iron consumed in Foundry				92	10	0
„ Sundry Trade Charges and Sale Expenses	6,220	8	6	„ Stock of Pig Iron				10,981	15	8
„ Balance carried to Profit and Loss Account	12,284	3	11							
	£61,084	10	0					£61,084	10	0

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* The practice in accounts of this kind is to debit and credit the initial and final stocks of coal, limestone, and other raw materials, in the Nominal Ledger Accounts, transferring the balances only of such accounts to the Manufacturing Account as representing the *net* cost of each item.

The divisions and appropriations in accounts of this description are frequently not very scientifically made. But if they suit the manufacturer's requirements, and the accounts are consistently prepared period by period, they will furnish material for the necessary comparisons. An example of a set of accounts prepared on lines set out in (*b*) is shown above, and a set prepared on lines set out in (*c*) above, on p. 15.

In a business where an efficient costing system is installed, the costing records govern the construction and division of the different sections of the Manufacturing, Trading, and Profit and Loss Accounts, thus enabling approximate reconciliation to be made between the costing and the financial records. It will be clear that in this case many charges normally dealt with in the Profit and Loss Account section will be transferred to the Manufacturing or Trading Account

MANUFACTURING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	Cr.	£	s.	d.
To Stock at commencement :—				By Stock at close :—			
Raw Materials . . .	2,100	0	0	Raw Materials . . .	3,100	0	0
Partly Manufactured Goods.	3,600	0	0	Partly Manufactured Goods	4,700	0	0
	5,700	0	0		7,800	0	0
„ Purchases of Raw Material (*less* Returns)	21,263	0	0	„ Amount transferred to Trading Account, being trade price of finished goods . . .	66,871	0	0
„ Manufacturing Wages . .	25,512	0	0				
„ Factory Power . . .	2,240	0	0				
„ Carriage Inwards on Raw Materials	567	0	0				
„ Factory Expenses . .	7,276	0	0				
	62,558	0	0				
„ Balance carried to Profit and Loss Account, being gross profit on manufacturing .	12,113	0	0				
	£74,671	0	0		£74,671	0	0

TRADING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	Cr.	£	s.	d.
To Stock of finished goods at commencement	10,216	0	0	By Sales (*less* Returns) . .	88,473	0	0
„ Manufacturing Account (trade price of goods manufactured)	66,871	0	0	„ Stock of finished goods at close	11,109	0	0
„ Purchases of Finished Goods (*less* Returns) . . .	526	0	0				
„ Packing and Distribution Expenses	9,267	0	0				
	86,880	0	0				
„ Balance carried to Profit and Loss Account, being Gross Profit on Sales . . .	12,702	0	0				
	£99,582	0	0		£99,582	0	0

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	Cr.	£	s.	d.
				By Gross Profit on Manufacturing	12,113	0	0
				„ Gross Profit on Sales . .	12,702	0	0
					£24,815	0	0

sections, otherwise the costing and financial records will not harmonise. Accounts thus prepared will show, as near as may be, the actual manufacturing cost of the articles produced. As a general rule, the cost so ascertained is brought forward as a debit to the Trading Account section, as representing the cost of the goods handed to the trading department for sale. If it is desired to ascertain the actual manufacturing profit secured, the goods handed over, and any stocks remaining wholly or partially finished, must be valued at the current market prices ruling for manufactured goods of similar kind. This procedure will produce a figure representing manufacturing profit apart from trading profit. A corresponding debit must, of course, be made in the Trading Account section.

Percentage and Comparative Trading Accounts.—It is customary and useful in some businesses to prepare Trading or Manufacturing Accounts with one or more additional columns to accommodate percentage figures showing the proportion which the expense figures bear to the turnover for the year, or a series of past years. These percentages are frequently very informative, and are more expressive than variations shown in sterling values. An increase of turnover is naturally accompanied by increases in such expenses as move in sympathy with it, and they should be in a fixed ratio to the turnover. But *fixed* charges should not as a rule increase. Increases in gross profit percentages are, of course, satisfactory if they arise from cheapened raw material, reduced expenses, or better selling prices, but care must be taken that they do not arise from inflated stock valuation. Such accounts are illustrated on p. 18.

Ess and Aye Modes, Limited.

DEPARTMENTAL TRADING ACCOUNT FOR THE

DR.

		Mantles.			Furs.			Tweeds.			Total.		
		£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
19... Jan. 1	To Stock	2,000	0	0	5,000	0	0	1,500	0	0	8,500	0	0
Dec. 31	To Purchases (net) . .	7,860	0	0	22,980	0	0	5,160	0	0	36,000	0	0
,, 31	,, Warehouse Wages .	3,186	0	0	4,840	0	0	1,850	0	0	9,876	0	0
,, 31	,, Salaries and Commission	1,215	0	0	2,716	0	0	1,501	0	0	5,432	0	0
,, 31	,, Heating and Lighting .	241	0	0	740	0	0	280	0	0	1,261	0	0
,, 31	,, Rent and Rates . .	1,000	0	0	2,000	0	0	800	0	0	3,800	0	0
,, 31	,, Balance carried to Profit and Loss Account .	1,258	0	0	3,125	0	0	1,101	0	0	5,484	0	0
		£16,760	0	0	£41,401	0	0	£12,192	0	0	£70,353	0	0

The student will realise that no stereotyped forms can be laid down for Trading and Manufacturing Accounts. Great divergency exists even in the same industry (with the possible exception of the brewing industry), and the preferences and requirements of the individual manufacturer frequently determine the precise form that these accounts shall take. So few companies publish these accounts that the student has little opportunity of inspecting an assortment of "live" accounts of the kind, but a series will be found in the author's *Accounting*, on pp. 24–32, to which the student who desires to pursue the subject further is referred.

Departmental Trading Accounts.—Where a business deals in several classes of goods, handled by separate departments, it is customary to prepare the Trading Account on departmental lines as shown above.

In the preparation of a Departmental Trading Account, as here illustrated, some figures will result from Nominal Ledger Accounts opened for each department, to which direct postings can be made of purchases, expenses, and sales, obtained by analysis where separate Day Books are not kept for each department. In other cases the items debited will result from the apportionment of various charges, such as rent, rates, heating, etc., upon some equitable basis. These matters are more fully dealt with in Chapter XIV.

When preparing trading accounts, certain matters may arise which require special treatment. Amongst these, the following may be mentioned:—

Goods on Approval.—If the "Sale or Return" transactions are numerous, a special Sales Journal should be kept to record them. A convenient ruling will be found on p. 19.

EAR ENDED DECEMBER 31, 19... Cr.

		Mantles.			Furs.			Tweeds.			Total.		
		£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
... .31	By Sales (net)	14,980	0	0	35,401	0	0	10,960	0	0	61,341	0	
31	,, Stock on hand	1,780	0	0	6,000	0	0	1,232	0	0	9,012	0	
		£16,760	0	0	£41,401	0	0	£12,192	0	0	£70,353	0	

No items are posted to the Ledgers until an actual sale takes place The amounts finally extended into the Sales column are posted i detail to the personal accounts of the purchasers, and, in monthly o other totals, to the Sales Account. At stock-taking periods, the balanc of goods still out on approval should be taken into stock at *cost*, o market price.

If, as is the case in some businesses, goods on appro. are treate as ordinary sales until returned, the amount of such outstandin "appro." sales must be deducted from the total sales for the perio and from the total "Sundry Debtors," and added to the stock valuatio as explained above. In some cases traders handle goods receive "on appro." from wholesalers. Care is needed to ensure that suc goods are not taken into stock, and the best method of preventing th is to segregate all "appro." goods before stock is taken. Speci records of the receipt and sale of "appro." goods must be kep especially as in some cases the trader is under obligation to purchas the goods if kept beyond a certain time limit. When such goods a sold, an invoice should be obtained and passed through the Purchas Book in the ordinary way.

Goods on Consignment.—These transactions should be treated in similar way to goods sent out on approval, and be taken into stock

PERCENTAGE TRADING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	Percentage on Sales.	£	s.	d.	Cr.	Percentage on Sales.	£	s.	d.
To Stock	28·20	5,640	0	0	By Sales (net)	100·00	20,000	0	0
,, Purchases (net)	64·81	12,962	0	0	,, Stock	24·25	4,850	0	0
,, Carriage Inwards	4·75	951	0	0					
,, Balance carried to Profit and Loss Account, being Gross Profit for the year	26·49	5,297	0	0					
	124·25	£24,850	0	0		124·25	£24,850	0	0

COMPARATIVE TRADING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	Percentage on Sales. 19...	Percentage on Sales. 19...	£	s.	d.	Cr.	Percentage on Sales. 19...	£	s.	d.
To Stock	—	—	12,500	0	0	By Sales (net)	100·00	56,000	0	0
,, Purchases (net) *	49·21	50·78	37,500	0	0	,, Stock	—	21,560	0	0
,, Manufacturing Wages	23·71	22·67	12,700	0	0					
,, Factory Power	6·01	5·73	3,210	0	0					
,, Balance, being Gross Profit for the year, carried down	21·07	20·82	11,650	0	0					
	100·00	100·00	£77,560	0	0		100·00	£77,560	0	0

* The percentages shown against this item represent net materials consumed.

SALES (ON APPRO.) JOURNAL.

Despatches.					Returns.					Sales.				Remarks.
Date.	Details.	Amount.			Date.	Details.	Amount.			Posting Folio S.L.	Amount.			
		£	s.	d.			£	s.	d.		£	s.	d.	

PACKAGE STOCK ACCOUNT.

Dr.   Cr.

	Quantity.	Value.				Quantity.	Value.		
		£	s.	d.			£	s.	d.
To Cash at 1s. each	1,000	50	0	0	By Package Trading Account at 1s. each .	300	15	0	0
					,, Balance carried down at 1s. each . .	700	35	0	0
	1,000	£50	0	0		1,000	£50	0	0
To Balance brought down at 1s. each .	700	35	0	0					

PACKAGE TRADING ACCOUNT.

Dr.

			Quantity.	Value. £	s.	d.
	£ s. d.					
To Sundry Debtors (per Sales Returns) at 1s. 6d. each			1,500	112	10	0
,, Package Stock Account (packages sold) at 1s. each			300	15	0	0
,, Balance carried down. Returnable packages in hands of customers at 1s. 6d. each			200	15	0	0
,, Profit and Loss Account :—	£ s. d.					
Profit on Hire, 2,000 at 1s. each	100 0 0					
Profit on Sales, 300 at 6d. each	7 10 0			107	10	0
			2,000	£250	0	0

Cr.

	Quantity.	Value. £	s.	d.
By Sundry Debtors (per Sales Day Book) at 2s. 6d. each	2,000	250	0	0
	2,000	£250	0	0
By Balance brought down	200	15	0	0

Note.—It is assumed that packages cost 1s. each, are invoiced to customers at 2s. 6d. each, and, if returned within 7 days, are credited at 1s. 6d. each. Quantity columns in the Sales Day Book, Sales Returns Book, and Sales Ledger enable the total accounts to be raised.

STOCK BOOK OF MANTLE FACTOR.

Received.									Sold.							
Date.	Style No. and Mark.	Quantity.	From whom Purchased (Name and Address).	Cost Price.			Manufacturer's		Date.	Purchaser (Name and Address).	S.L. Folio.	Quantity.	Sale Price.			Remarks.
				£	s.	d.	Style No.	Marks.					£	s.	d.	

cost or market price, care being exercised to ensure that they have not been included with ordinary sales. In the reverse direction, care must be taken that goods received on approval, or on consignment, are not taken into stock until the actual property in them has been acquired. Goods out on consignment are preferably stated separately in both Trading Account and Balance Sheet.

Forward Invoices.—Where it is the practice to invoice goods forward, care must be taken to ensure that goods have not been taken into stock when the relative invoices have not been entered in the Purchases Journal. The correct treatment is to include such transactions in both Purchases and Stock as the property in them has passed.

Packing Materials.—Where packages are numerous and costly, it is a common practice to keep record of them in special columns added to the Sales and Returns Inwards Journals and the Sales Ledger, a corresponding "Packing Materials Account" being opened in the Nominal Ledger. In this way, each customer is debited (from the Sales Journal) with packing materials when goods are despatched to him, and credited (through the Returns Inwards Book) when he returns the empties. The total of the packing materials column in the Sales Journal is posted to the credit of "Packing Materials Account," and the total of the Returns Inwards column is debited to the same account. Thus efficient check is kept upon an important item, which, if loosely dealt with, will lead to inaccurate accounting. Sometimes all records relating to packages are recorded on cards, and do not appear in customers' accounts of goods sold.

Where the original cost of packing materials is heavy, it is preferable to deal with the item in the Trading Account. If no charge is made for packing, the item should appear as a distribution cost in the Profit and Loss Account. Where crates, barrels, cases, etc., are charged to customers at a figure above cost, and an allowance less than the amount charged is made on return, it is advisable to open a Package Trading Account and credit it with all packages charged out, debiting it with all returns. The cost of packages purchased is debited to a Package Stock Account, which is credited with the cost of packages retained by customers and paid for, a corresponding debit being made to Package Trading Account; the latter account, after carrying down as a credit balance the contingent liability represented by returnable packages, shows the profit on hire and sale of packages. The packages in stock should be depreciated either by crediting a Depreciation Account or by valuing the stock at a figure lower than cost. See illustration on p. 20.

Carriage.—Sometimes the carriage incurred in conveying to the works new machinery and plant, or similar assets, is charged to the asset account. In certain circumstances this is permissible, provided the item is written off with reasonable promptitude. When an examination trial balance contains the items "Carriage Inwards" and "Carriage Outwards," it is an indication that the former item is to be charged to the Trading Account and the latter to Profit and Loss Account.

Wages and Salaries.—It frequently happens that the close of a financial year does not synchronise with the end of a week. It is then necessary, particularly in a manufacturing business, to ascertain and pass through the books the wages and salaries accrued due from last pay day to the date of closing the books. This information can be obtained from the wages books or pay rolls. The same remarks apply to commission due to travellers and others.

Stock-in-Trade.—Inaccurate stock valuations will affect the accuracy of the trading results shown by the accounts. The stock sheets should be prepared under the supervision of responsible officials, who should fix the valuation prices of the goods. All calculations and quantities should be cross-checked by two or more persons. Stock stored in bulk in stacks or otherwise, such as coal, coke, mineral ores, and the like, is generally valued by measurement. The calculations should be checked by competent persons. Record should be kept of all goods added to, or withdrawn from, bulk, and this, if accurate, will afford a check upon the stock-taking valuation. Care must be taken that no goods are taken into stock, the invoices for which have not been passed through the books, or which have been sold and charged up, but not delivered. On the other hand, it is necessary to include in the stock all goods which have been included as purchases and have not yet been sold, particularly where the goods are in outside warehouses or wharves, or in transit, at the date of stock-taking.

The basis of stock valuation *must* be consistent from year to year, otherwise comparisons of trading results will be useless, since the profits of one period may be inflated at the expense of the succeeding period. Values should be based (*a*) upon cost price, less allowances for damaged, unpopular, or obsolete stock; or (*b*) upon market prices, if these appear to have fallen permanently below cost price. If market price is higher than cost, it is clearly dangerous to base the valuation on market price, unless one is assured that the superior market price will be maintained. Raw materials are frequently valued upon the average cost during the year.

The only legitimate departure that can be made from the cost basis of valuation occurs in some few trades, *e.g.* the wine and spirit and timber trades, where stocks held for future sale increase in value as they mature in quality. Most wines improve with age, and a conservative addition, representing a percentage on cost, may therefore be added to the original cost from period to period, provided that the valuation never exceeds the price at which wine of the same vintage and age can be purchased in the market.

In manufacturing businesses, where a proper costing system is employed, the Stores Books, Bin or Locker Cards, and similar records are of the greatest assistance for stock-taking purposes, as is explained in Chapter XV. In non-manufacturing businesses, proper stock books should be employed, suitable for the particular needs of the business. An example of a Factor's Stock Book is shown on p. 20, recording the receipt and issue of goods. This record affords a check upon stock, and greatly facilitates stock-taking, besides affording useful information as to the popularity or otherwise of any particular line which has been purchased. Separate Stock Books are frequently kept for each department or class of goods dealt in.

Work in Progress.—Manufacturing or contracting businesses will usually have at the close of the year a certain amount of work in hand, which will not be completed till the next financial year. The valuation of " work in progress " requires the utmost care. In some cases the value of the work taken credit for in the Trading Account should not exceed its actual cost, *i.e.* the cost of the raw materials used, wages expended thereon, and proportion of Oncost, up to the close of the financial period. In other cases, where, for example, the work is within sight of completion, and the final cost can be exactly estimated, a measure of profit may be added to the valuation, if possible contingencies are also taken into account. The accountant is necessarily largely dependent upon the technical experts for the data required to compute the cost of completing unfinished work.

Some examination candidates appear to experience difficulty when they find included in a Trial Balance a debit balance for work in progress, and a further valuation under the same heading at the close of the period. The balance forming part of the Trial Balance should be debited to the Manufacturing Account immediately after the initial " Stock in hand," and the valuation at the close of the year, appearing in the " instructions," should be credited to the same account immediately after the final " Stock in hand " and shown in the Balance Sheet.

Goods in Transit.—Goods purchased and in course of transit must be taken into stock at cost if the invoices relating to them have been passed through the books, as they should be if the property in the goods has passed.

Trade Discount.—All trade discounts must be deducted from sales and sundry debtors. In some trades these discounts are very heavy, and omission to deduct them would result in a fictitious gross profit being shown.

II. Profit and Loss Accounts.

As regards limited companies, distinction must be made between a Profit and Loss Account as drawn up for the information of the directors and a Profit and Loss Account for publication to the members of the company in compliance with the Companies Act, 1948. This Act requires the disclosure of certain prescribed information. This information is, of course, a minimum, and there is nothing (in law) to prevent disclosure of much fuller figures, even to the extent of setting the full trading account and the totals of all revenue and expenditure under detailed headings. In practice, such full disclosure is rarely, if ever, made: nearly all boards of directors confine the published Profit and Loss account to the statutory minimum, with sometimes a few additional items which they consider will be of interest to the members but knowledge of which by the company's competitors will not be harmful. A consequence of this differentiation is that normally the Profit and Loss Account (proper) is divided into two portions: the first part is confidential and for the information of the directors only, and the balance is carried to the second part which is for publication.

It can, nevertheless, be asserted that the common aim of all Profit and Loss Accounts, however drafted, is to ascertain the *net profit* for the period. The following definition by an examination candidate is worthy of quotation. "Net profit is the amount available for distribution to the proprietor, partners, or shareholders of a business, after all charges that have been incurred in the earning of the revenue for the period under review have been taken into account, and the shrinkage in the value of the assets held by the business has been allowed for."

Limited companies rarely publish Trading or Manufacturing Accounts, and there is a growing tendency to publish Profit and Loss Accounts as greatly abbreviated as ingenuity can devise and the law permit. The result is that many items which, in theory, should appear in the Profit and Loss Account are charged in the Trading Account, and are thus hidden from observation. It should be remembered that, unless the form of the Profit and Loss Account is prescribed by Statute, the manner of its presentation is entirely at the discretion of the directors, and the auditor cannot impose his views unless, of course, the account it is proposed to publish is inaccurate or misleading.

The Companies Act, 1948, makes it compulsory for every company within the meaning of that Act to lay before a general meeting, at least once in every calendar year, a Profit and Loss Account (or Income and Expenditure Account, if more appropriate). This account must disclose, *inter alia*, the amount charged for the depreciation of fixed assets, the total remuneration (not merely the fees) of the directors, the charges for taxation, distinguishing between income tax and other taxes, interest payable on the company's debentures or fixed loans, amounts added to (or taken from) reserves, and the dividends paid or proposed.

The particular form in which the items composing a Profit and Loss Account should be stated must of necessity vary with different businesses. It is suggested, however, particularly for costing purposes, that the following grouping is desirable:—

(a) *Sales Expenses.*—Salaries of Sales Staff, and Travellers; Commission; Advertising; Window Publicity; Warehouse and Store Rent, Rates and Expenses, and the general expenses of selling the goods dealt in.

(b) *Distribution Expenses.*—Carriage Outwards; Cartage; Freight; Expense of Motor Lorries or Vans; Wages of Drivers, Packers, Porters, and the general expenses of distribution.

(c) *Administration Expenses.*—Directors' Fees; Managers' and Clerks' Salaries; Office Rent; Rates and Expenses; and the general expenses of management and supervision.

To summarise on broad lines:—

(1) *Business of Factor, Merchant, or Distributor.*

(a) *Trading Account.*—Debit the account with the initial stock, purchases, and the cost of getting goods into the warehouse or store. Credit the account with Sales and the final stock. The balance represents *gross* profit.

(b) *Profit and Loss Account.*—Credit the balance of gross profit from Trading Account, discount (if a credit balance), and similar items. Debit all sales expenses, carriage of goods outward, distribution expenses, and administration expenses. The balance represents *net* profit.

(2) *Manufacturing Business.*

(a) *Manufacturing Account.*—Debit the account with the initial stock, purchases of materials, productive wages, rent, rates, and expenses of factory, carriage of goods inward, and every expense incurred in the production of the articles manufactured. Credit sales and final stock. The balance represents *gross* profit.

(b) *Profit and Loss Account.*—As in (1) (b).

Some difference of opinion exists as to the proper treatment of discount on Sales and Purchases. It is submitted that all *trade* discounts should be dealt with in the Trading Account, and *cash* discounts in the Profit and Loss Account. The student will be aware that it is usual to deduct trade discounts when invoicing goods, so that only *net* amounts appear in the Sales Journal—in most cases, therefore, no actual entries regarding trade discounts appear in the books. Similar diversity of opinion also exists in the treatment of carriage, and the examination candidate will be well advised to treat all *carriage inwards* in the Trading Account, and *carriage outwards*, as part of the cost of distribution, in the Profit and Loss Account.

Errors in Examination Work.—The examination candidate has been advised to confine the Trading Account to the prime cost of the articles dealt in. The items remaining in the Trial Balance, chargeable against revenue or to be added thereto, after the items appertaining to the Trading Account have been dealt with, must perforce appear in the Profit and Loss section. These items will consist mainly of distribution and management costs, items of revenue also appearing occasionally. Before the account can be closed, certain adjustments, *e.g.* provisions for wastage, etc., will be necessary, but these are contained in supplementary "instructions," and do not figure in the Trial Balance. Analysis of a few typical examination Trial Balances will disclose that the revenue items remaining after the preparation of the Trading Account consist chiefly of such items as: Rent, Rates, Taxes, Interest, Bad Debts, Office Expenses and Salaries, Directors' Fees, Carriage Outwards, Transfer Fees, Royalties, Legal Expenses, Travellers' Salaries and Commission, Preliminary Expenses, Discount, Insurance, Bank Charges, Advertising, Postages, Stationery, Apprentices' Premiums, Trade Expenses, etc.

In the absence of specific instructions to the contrary, the items set out above should be dealt with in the Profit and Loss Account section. Careful attention must, however, be paid to any *indication* as to the proper treatment, which may not actually be expressed in so many words. For instance:—

(*a*) If the question deals with the accounts of an engineer, and "apprentices' premiums" appear in the Trial Balance, the item should be apportioned over the period of the indentures (if mentioned in the question), and the portion applicable to the period covered by the accounts should be credited in the Manufacturing Account, since the apprentices are taught in the factory, and the factory should have credit for the fees earned.

(*b*) Again, items may appear as follows: *Rent and Rates* (*Factory*, £1,692; *Office*, £450), £2,142; *Insurance* (*Warehouse*, £345; *Office*, £80), £425. Stated in this way there is clear *indication* that the Factory (or Warehouse) and the Office are to be charged with the expense in the proportions given within the brackets. Candidates frequently ignore these indications and lose marks in consequence.

Almost without exception, an examination Trial Balance is accompanied by instructions directing various adjustments to be made before closing the Profit and Loss Account. Experience shows that more candidates come to grief through incorrectly treating these adjustments, or failing to deal with them completely, than from any other cause. It may be well, therefore, to select a few typical adjustments from actual examination questions and show where the candidates went wrong in dealing with them.

Illustration (*a*).—"The following valuations were made as on December 31, 19...: Stock, £6,892; Motor Lorries, £2,896; Loose Tools, £1,700. . . . Depreciation is to be provided as follows: Plant and Machinery, 10%; Office Furniture, 5%."

In the Trial Balance, Motor Lorries stood at £3,420, and Loose Tools at £1,998.

Some candidates dealt correctly with the provision for depreciation on Plant and Machinery and Office Furniture, but entirely overlooked the plain *indication* that Motor Lorries had also been depreciated (by valuation) by £524, and Loose Tools by £298. This oversight resulted in an overstatement of the net profit by £822. This is a common error.

Illustration (*b*).—"The Debenture Interest accrued due as on December 31 had not been provided for." The candidate was informed that the company had issued £20,000 5% Debentures on January 1, and, in the Trial Balance, £500 appeared as a debit to Debenture Interest Account. This was an *indication* that the only interest outstanding was that accrued due for the *half-year* to December 31. Many candidates, ignoring the indication, charged the accounts with a full year's interest in addition to the debit mentioned above, *i.e.* with £1,500. Careless oversight of such a point as this is a common experience.

Illustration (*c*).—"Manufacturing Wages (£962) were spent in making new patterns for use in the Company's factory." "Patterns Account, £500," appeared in the Trial Balance. A number of candidates deducted £962 from the wages in the Manufacturing Account, but failed to add a like sum to the asset account (Patterns), and therefore, of course, failed to "balance." This is typical of adjustments incompletely effected by candidates through dealing with one aspect only of the adjustment. Outstanding wages, salaries, directors' fees, and the like also provide fruitful examples of these one-sided adjustments, omission being made to schedule them as creditors in the Balance Sheet.

Illustration (*d*).—In the reverse direction, the treatment of revenue expenditure, the benefit of which extends beyond the period covered by the accounts, is equally productive of error in examination work. For example: "Insurance (Factory, £102; Office, £15), £117, is to be carried forward to next year." Some candidates made the necessary deductions from the Insurance items in the Manufacturing and Profit and Loss Accounts, but omitted to schedule the

£117 as a temporary asset in the Balance Sheet as "Expenses Paid in Advance," and thus failed to "balance."

These errors would be obviated if candidates would remember that all adjustments, outside the Trial Balance, affect *both* the Balance Sheet and either the Manufacturing, Trading, or Profit and Loss Account. It is, therefore, necessary to complete the double entry by dealing with each adjustment *twice*.

REVENUE EXPENDITURE.

Revenue expenditure may be defined broadly as expenditure that does not increase the value of the fixed assets by the use of which the income of an undertaking is earned. Such expenditure consists of the cost of maintaining the fixed assets in efficient working order, the cost of manufacturing and distributing the goods dealt in, and the management expenses of the business. It is sometimes difficult to differentiate between Capital Expenditure and Revenue Expenditure. Capital Expenditure may be deemed to consist of the cost of any additions or alterations to capital assets that increase the earning power of the business; Revenue Expenditure consists of the cost of reconstructing or rehabilitating fixed assets—ordinary replacements, renewals, and repairs of such assets. We will consider here typical items of revenue expenditure which commonly find a place in Examination Trial Balances:—

Wages.—As already stated, the close of a financial year is not always coincident with the end of a working-week. Wages accrued due since the last pay day to men employed in the distribution side of the business should be charged to Profit and Loss Account; but if wages have been paid in respect of capital expenditure, a transfer should be made from the credit of Wages Account to the debit of the particular Asset Account. Wages paid to the workmen of a firm or company for time spent upon plant and machinery installation, the making of loose tools, building extensions and the like require this treatment.

Illustration.—"Manufacturing Wages, £268, had been expended in the installation of Plant in the Company's Factory."

Here, Manufacturing Wages, in the Manufacturing Account, should be reduced by £268, and a like amount be added to the Plant account *before* provision is made for depreciation at the stated rate.

In theory, Journal entries should be made for outstanding wages and similar items. In practice, the relative Ledger account is debited with the amount accrued, and this amount is then brought down as a credit balance, and is scheduled amongst "Sundry Creditors" in the Balance Sheet.

WAGES ACCOUNT.

Dr. Cr.

		C.B.	£	s.	d.			P.L.	£	s.	d.
19..						19..					
Dec. 31	To Cash. Wages paid to date .	62	5,367	0	0	Dec. 31	By Trading Account	16	5,502	0	0
" 31	" Three Days' Wages accrued to date, carried down . .	✓	135	0	0						
			£5,502	0	0				£5,502	0	0
						19..					
						Dec. 31	By Balance brought down . .	✓	135	0	0

Salaries.—Here also salaries accrued due must be provided for. The outstanding amount must be added to the Salaries item in the Profit and Loss Account and to the Sundry Creditors in the Balance Sheet. If the accounts are those of a manufacturer, the salary of the factory manager should be charged in the Manufacturing Account. In examination work, if the Factory Manager's salary is separately stated, it is an *indication* that the amount should be charged against gross profits. Partners' salaries should be separately stated in view of the requirements of Schedule D (Income Tax) as dealt with later.

Directors' Fees, etc.—The fees to which Directors are entitled will be disclosed either by the Articles of Association or by resolution of the shareholders in general meeting, recorded in the Minute Book; the Managing Director's salary and commission (if any), should one of the board have been appointed to act as such, will be fixed in his agreement with the company, or by a Directors' Minute; travellers' salaries and commission will be fixed by their agreements; and the auditor's remuneration usually by resolution of the shareholders.

The total remuneration of the directors, whether or not it has been wholly drawn, must be disclosed, and the best method is to show it as a charge in the first of the published sections of the Profit and Loss Account. It is necessary to distinguish between "emoluments in respect of services as director" on the one hand, and "other emoluments" on the other. "Other emoluments" would include, for instance, a salary paid to the company's secretary, if he also happened to be a director, and any salary, commission, bonus, etc., payable to a manager who is also a director.

Directors may waive their fees, if they wish to do so, and if this has been done (which will be evidenced by suitable minutes, etc.) the unpaid fees which have been waived will not be provided for in the accounts.

If any part of the remuneration cannot appropriately be shown in the Profit and Loss Account (as might be the case, for instance, where one of the directors managed a factory and his salary for acting in that capacity was regarded as a manufacturing charge) then the total remuneration must be stated separately by way of a note: the amount of detail to be disclosed (if any) is optional.

It is improper for a company to pay directors' fees "free of income tax" unless this is duly authorised, since to do so would be equivalent to paying additional fees.

Examination questions frequently indicate that charges mentioned above in the first paragraph of this section are outstanding.

Illustration.—"Directors' Fees half-year to June 30, 19..., £500." Such an extract from an examination Trial Balance indicates that candidates are required to provide for the half-year's fees, £500, July 1 to December 31, 19... Directors' Fees, £1,000, must therefore be charged in the Profit and Loss Account, and £500 must be added to the creditors in the Balance Sheet for fees due but unpaid.

Renewals and Repairs.—Renewals need very careful consideration If they represent the installation of a new in place of an old machine the cost may be capitalised by transfer to "Machinery and Plant Account," always provided that any balance that may remain on the old asset account, after crediting thereto the proceeds of sale of the old asset, is written off against revenue.

Very heavy repairs occur every few years in certain trades, *e.g.* where powerful acids are employed in manufacture, and then it is usual and legitimate to spread the cost over those years which benefit from the outlay, thus equalising the charges against profits. The amount held in suspense is carried to a Repairs Equalisation Account (Maintenance Reserve). Sometimes an account of this kind is created by annual transfers from Profit and Loss Account of equal amount, the cost of all repairs actually executed being debited against the fund. The annual contributions to the fund are determined by the actual expenditure upon repairs incurred in past years. If this practice is adopted, care must be taken that the fund is in credit at the close of the financial period. Should the fund be in debit, it will be obvious that the annual contribution needs to be increased, unless the deficit is due to abnormal circumstances, which will adjust themselves in the near future.

A fund of the kind is useful where it is known that in later years particular assets will demand heavy repair expenditure, or where the repairs will be irregular in their incidence. In such cases an estimate of the repair cost for the whole "life" of the asset or assets should be made, an equal proportion of which should then be charged against the Profit and Loss Account for each year of the assumed "life" of the asset or assets.

Building Renewals and Repairs.—These are governed by the same considerations as outlined above. Unless they permanently increase the value of the property, or add something which was not there before, all repairs and renewals should be charged against revenue.

The operation of a Repairs Equalisation Account is shown in the following accounts:—

PROFIT AND LOSS ACCOUNT.

Dr.	£	s.	d.		£	s.	d.	Cr.
To Repairs Equalisation Account (annual instalment) . . .	250	0	0					

REPAIRS ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Cash. Cost of Repairs for the year	210	0	0	By Transfer to Repairs Equalisation Account	210	0	0
	£210	0	0		£210	0	0

BALANCE SHEET.
(Liabilities Side.)

	£	s.	d.	
Repairs Equalisation Account	40	0	0	

Machinery Repairs.—These, if separately stated, should appear in the Manufacturing Account, since they represent the cost of maintaining the machinery asset in a fit state to earn revenue.

Carriage, Freight, etc.—Carriage, etc., inwards of raw materials, stores, goods for re-sale, and the like should be charged in the Manufacturing or the Trading Account, being part of the prime cost of manufacture, or of acquiring the goods for re-sale; carriage outwards on finished goods despatched, or merchandise re-sold, should appear in the Profit and Loss Account as a distribution expense.

Returns.—Returns both inwards and outwards should be deducted respectively from the Sales and Purchases in the Trading Account in order that the net figures of Sales and Purchases should be shown in each case. Some examination candidates deal with the balance of returns only, a practice which is not in accord with commercial usage, since it does not give a correct figure of the actual turnover for percentage comparisons.

Rent, Rates, and Taxes.—All outstanding liabilities under these heads must be provided for, and any payments in advance must be correctly apportioned. Rates may cover a period beyond the close of the financial year, and in that case they should be apportioned between the two periods, and the prepaid portion be held in suspense as an asset.

Rents received will be credited to the Trading Account, if derived from sub-letting a portion of the factory or warehouse; if office accommodation is sub-let, the rent received will be credited to Profit and Loss Account.

Sometimes rent is received for the use of power supplied to tenants or neighbours. In that case the rent should be credited to the Trading Account, or be deducted from the cost of power in that account.

Where much property is held and let, the "Terrier" (Plan of Estate and Rent Register) will provide the information for checking rents receivable, in order to ascertain outstandings. All rents accrued due must be taken into account, and provision must be made for irrecoverable arrears.

In examination work attention must be paid to any indication that charges or outstandings in respect of rent, rates, and taxes are to be split up between the Trading and Profit and Loss Accounts. If a Trial Balance contains a credit item, "Rents Received," the amount should be credited to the Profit and Loss Account, and not be deducted from rent paid, as candidates sometimes do.

Ground Rent.—Rent paid for the occupation of land upon which houses, offices, or factories are built should be treated as outlined above, and should be apportioned, if possible, between the factory and the office. Ground rent should be stated separately in the Profit and Loss Account. The item should be shown "gross," *i.e.* any income tax deducted on payment should be debited to Ground Rent Account and credited to Income Tax Account.

Royalties.—Royalties are dealt with in Chapter XVII. In the case of quarries or mines they are a charge against the Working Account. In other cases they consist of fees paid to patentees, owners of copyright, etc., for the right of user of patent machinery, manufacturing processes (constructional, chemical, etc.), or for the right to reproduce and sell copyrighted works. In all these cases the royalty should be charged against the Manufacturing or Trading Account. Such royalties are usually payable upon some agreed unit of manufacture or sale, and are fixed by agreement between owner and user. Any royalties accrued due on output or sales, as the case may be, since the last settlement date must be passed through the books, Royalties Account being debited and credited as shown in the case of Wages Account on p. 27. Any income tax deducted on payment should be adjusted as in the case of Ground Rents, as explained above.

Trade Expenses.—This is an omnibus account which includes a multitude of items of diverse kinds. Both the term and the account are often loosely employed, since, usually, it covers both Trading and Profit and Loss items. In practice, the account is frequently allocated as between Trading or Manufacturing Account and Profit and Loss Account. If the examination candidate is given no guidance as to the treatment required, he should charge the whole to Profit and Loss Account. Sometimes, however, indication of treatment is afforded in an examination question, thus:—

> *Illustration.*—In the Trial Balance there appears "General Trade Expenses (Factory and Offices), £898," and, later on, the information is given that "the offices occupy one-eighteenth of the floor-space of the company's property." This is an indication that one-eighteenth of the general expenses should be charged to Profit and Loss Account.

The modern tendency is to divide expenses of this kind into "Factory Expenses" and "Office Expenses." If separate items under these headings appear in a Trial Balance they are doubtless required to be charged to Trading and Profit and Loss Account respectively.

The Inland Revenue officials are apt to be somewhat curious as to the composition of the Trade Charges items in accounts submitted to them; it is advisable, therefore, to describe this debit in the following detail: "Postages, Telegrams, Trade Subscriptions, and Petty Expenses, not including any items not allowable for income-tax purposes." Any items not allowable for income tax, such as charitable subscriptions and donations, etc., should be stated separately.

Stationery, Stamps, etc., in Hand.—Where the expenditure under these, and similar, headings is small, it is usual, in practice, to ignore any stocks on hand. But in some businesses the stock of stationery, catalogues, postage stamps, patent medicine, or entertainment-tax stamps, and similar items may be of considerable value. It is then customary to take stock, and to credit the relative expense account with the valuation, bringing the balance down as stock in hand, and either stating it separately or adding it to the trading stock as an asset in the Balance Sheet.

Interest on Loans and Debentures.—All accrued interest must be provided for and added to the interest charge in the Profit and Loss Account, and to the Sundry Creditors in the Balance Sheet. Inspection of the "Register of Mortgages and Charges" will furnish the particulars necessary to ensure that all due interest has been provided for. Outstanding interest on bank loans, usually debited quarterly, can be ascertained by scrutiny of the entries in the Pass Book immediately following the close of the financial period. Examination questions frequently indicate that interest has accrued due, and failure to schedule the item amongst the creditors in the Balance Sheet is a fruitful source of error.

Interest received should be credited to Profit and Loss Account. It will probably have resulted from loans or investments, or from charges made in respect of overdue accounts, or for the renewal of bills of exchange, and is, therefore, a *financial* transaction.

In partnership accounts, interest on capital and drawings should be stated separately, and not be combined with trade or investment interest, as some examination candidates are apt to do.

Students sometimes fail to understand that debenture interest is a *debt* due to *creditors*, payable by the company whether the profits made are or are not sufficient to discharge the debt. Debenture interest is in a category essentially different from outstanding "interest" on Preference Shares. Preference dividends are an allocation of profits, and their payment is contingent upon sufficient profits being made from which to discharge them.

Trade Interest.—Interest received or paid in connection with the discounting of bills; interest on overdue accounts; interest payable to factors on bonded goods not withdrawn from bond; interest, in the nature of fines, levied in accordance with trade custom, and the like, should be treated in a separate account, and not be included with loan and other fixed annual interest.

Discount.—Trade discount must, of course, be deducted from all sales before they are credited in the Trading Account. The examination candidate is entitled to assume that the purchases and sales appearing in the Trial Balance are stated *net*, *i.e.* after deduction of *trade* discount.

In some cases cash discounts received on purchases, or allowed on sales, are deducted from the purchases or the sales items in the Trading Account. Strictly speaking, perhaps this is the more accurate treatment, though the point is debatable, but in the great majority of businesses a single account is opened for cash discounts received or allowed, the balance only being debited or credited as the case may require in the Profit and Loss Account. This course is usually followed when answering examination questions. If, however, both the debit and the credit totals of discount are given in the Trial Balance, it is an indication that the discounts on purchases and sales are to be treated in the Trading Account.

Examination questions sometimes demand the creation of a provision for discounts. Such provisions are rare in practice. Trade discount, as we have seen, does not reach the Ledger, since it is deducted in the Sales and Purchases Books. Cash discount, it is contended, is contingent upon the debts being paid on or before the expiration of the customary period of credit. In some cases the discount is allowed, in others it is disallowed. In the author's opinion, cash discounts should be treated as financial transactions. If a provision for discounts is made, the procedure is precisely similar to that employed in the case of provisions for Bad and Doubtful Debts, viz. a debit to Profit and Loss Account of the amount of the provision, a like amount being deducted from Sundry Debtors in the Balance Sheet. If a provision is made for discounts on debts due to creditors, the entry in the Profit and Loss Account is reversed, the Sundry Creditors being reduced by the amount of the provision.

Insurance.—This charge frequently covers a period in advance of the financial year covered by the Accounts. The proportion of the premiums paid applicable to the next financial period should be credited to the Insurance Account and treated as a temporary asset in the Balance Sheet. Such an adjustment is frequently required by examination questions, and failure to deal with *both* aspects of the adjustment is a common occurrence.

Advertising.—When a new commodity is introduced to the public by means of large advertising expenditure, it is the practice, in some cases, to spread a proportion of the initial expenditure over several years, and to treat that portion of the expense not charged to current Profit and Loss Account as a temporary asset to be written off over a period as in the case of Preliminary Expenses. There can be no objection to this procedure, provided that the amount carried forward is determined reasonably. When the cost of advertising has subsided to the normal annual expenditure estimated as necessary to maintain the sale of the commodity in public favour, all advertising expenditure must be charged to Profit and Loss Account for the year in which it is incurred.

Commission.—Commission paid to travellers and salesmen is a selling expense, and should be charged to Profit and Loss Account. The destination of commission earned will depend upon the nature of the business. Where, for example, a mantle manufacturer sells goods of his own make, and also goods of a foreign manufacturer on commission, the commission earned should be credited to Trading Account as profit earned by the warehouse. If, however, the commission earned was in respect of financial assistance to the foreign manufacturer, then the income should be credited to Profit and Loss Account.

Managing Directors are sometimes entitled to commission on gross turnover, or on gross or net profits, or on dividends paid to shareholders. The sum due under these heads will need careful computation in accordance with the agreement between the director and the company, and, if it is based upon profits or dividends, should be debited in the Appropriation Section of the Profit and Loss Account. If the commission is based upon turnover, it should be debited to Trading Account, and care must be taken that all returns are deducted, and that the commission is calculated on *net* sales. Income Tax cannot, in the absence of agreement, be treated as a charge against profits in calculating the amount of a manager's commission based on a percentage of the profits (*Johnston* v. *Chestergate Hat Manufacturing Co.*, [1915]).

Preliminary Expenses.—These consist of the expenses incurred in the registration and flotation of limited companies. They comprise, *inter alia*, stamp duties and registration fees; the cost of printing, advertising, and distributing the prospectus; printing the Memorandum and Articles of Association; professional fees to solicitors, accountants, valuers, etc.; underwriting commission, and the like. A special ledger account is opened to which such expenses are debited. The company could not have been brought into being without this expenditure, and it is unfair that the first year's trading should bear the whole brunt of this outlay. The usual practice is, therefore, to spread the expenditure over the first three or five years of the company's trading. That such treatment is within the powers of a limited company was recognised in *Bale* v. *Cleland*. The balance of the account *must* be separately stated as a temporary asset in the Balance Sheet. If the promoter of the company has undertaken to pay all preliminary expenses, care must be taken to ensure that all proper expenses have been charged to the account. Care must also be taken that the total expenses do not exceed the estimate which forms a necessary part of the Statutory Report and Prospectus, though there would appear to be no penalty if the estimate is exceeded.

Dividends Paid.—Preference dividends paid during the current year, or interim dividends paid on ordinary shares, should be entered in the Appropriation Section of the Profit and Loss Account, as explained later, and should not be debited in the main section of that account, as many examination candidates are in the habit of doing. To debit such payments in the main section of the account tends to obscure the account and to make it difficult to see at a glance the actual trading result for the year.

It is obligatory also to set out dividends *proposed* to be paid, and, of course, it is important to distinguish clearly between dividends which have been paid and those which are proposed. The following is a suitable method:—

PROFIT AND LOSS ACCOUNT.

(DEBIT SIDE OF APPROPRIATION SECTION.)

	£	s.	d.
To Dividends on Share Capital (*less* income tax):—			
On 5% Preference Shares, paid for the year	3,300	0	0
On Ordinary Shares:			
Interim dividend of 1s. 3*d*. per share paid	16,500	0	0
Final dividend of 1s. 9*d*., per share now recommended, making 3s. 0*d*. in all for the year	23,100	0	0
,, Balance carried forward	8,550	0	0
	£51,450	0	0

Deferred Revenue Expenditure.—Exceptional and costly expenditure is sometimes "held up" in the Balance Sheet, a fixed proportion being charged annually over a period to Profit and Loss Account, as in the case of Preliminary Expenses. The expenditure held in suspense is treated as a temporary asset as explained on p. 34. In some cases special power is given by the Articles to the directors to spread expenditure over a term of years when justified by the nature of the outlay. Apart from this, there does not appear to be any direct legal sanction for the procedure, although it has long been confirmed by custom, and is recognised in the Companies Acts, in the case of preliminary expenses, expenses of issue of shares and debentures, commissions on placing shares, etc., which must each be shown separately on the Balance Sheet until written off.

Financial Expenses.—These usually consist of Bank interest and charges; interest on loans and debentures; discount, commission, and similar charges, connected with the financing of private or joint-stock enterprises. They are in a somewhat different category from deferred revenue expenditure mentioned above, but they are charges against revenue, and must be dealt with in the Profit and Loss Account.

Income Accrued.—Revenue of this kind, consisting of interest, rents, and the like, must be treated in the reverse way from the charges against profits enumerated above. Profit and Loss Account must be credited (by means of additions to the relative items), and "Sundry Debtors" be increased by the same amounts. The various ledger accounts will be treated in the manner shown on p. 27, except that the entries will be reversed. Dividends, however, should not be anticipated. As regards dividends on ordinary shares this is almost self-evident, since the amount of the dividend cannot be known till the dividend is declared, and therefore there is no ascertained figure on which to base a calculation. It is true also, however, with regard to preference dividends; since these do not become a debt till they are declared they cannot properly be regarded as accruing; even where it is known that they have in the past been so well covered by profits that the declaration in due course may be considered a moral certainty it is better not to anticipate the actual declaration. On the other hand, it is permissible to take credit for, and bring in as an asset, any dividend, whether preference or ordinary, receivable out of the profits of a period ending not later than the date of the Balance Sheet we are drawing up and actually declared before the date on which we are preparing our accounts. The required information for entries in respect of income accrued can be ascertained from the ledger accounts relating to investments or from the Investment Ledger if one is kept.

Transfer Fees.—Receipts under this heading will, of course, appear only in the Trial Balance of a limited company. The charge for registering the transfer of shares from seller to buyer in the share registers of a limited company is usually at the rate of 2*s.* 6*d.* per deed. Income from this source can be checked with the number of transfers filed, and should be credited in the Profit and Loss Account in a separate item, and not be deducted from office expenses, as examination candidates sometimes do.

Apprentice's Premiums.—It has been stated already (see p. 26) that in the accounts of manufacturing concerns these premiums should be credited to Manufacturing Account. Examination questions sometimes contain information to the following effect: "Apprenticeship fee (£500) received from A. B. for five years' articles, one year of which has expired." This is an indication that the candidate is required to credit one year's fee (£100) to the current year, and to carry forward the balance of £400 as a liability in the Balance Sheet to be dealt with in equal annual instalments as the years expire.

Profit on Sale of Investments.—If the undertaking be that of a finance or trust company, whose business it is to deal in investments, any profits or losses made are properly dealt with in the Profit and Loss Account. Profits made on the sale of investments held by trading companies may also, without grave objection, be taken to Profit and Loss Account and distributed as dividend. But if the investments held form part of a reserve fund, it is suggested that any profits realised on their sale are more wisely taken to the reserve fund and re-invested.

Premiums on Issue of Shares.—These are obviously of a capital nature. Prior to 1948 it seems there was no legal bar, notwithstanding this, to their being credited to Profit and Loss and distributed as dividend. The 1948 Act, however, has altered this position (S. 56). This section lays down that henceforward any such sum must be transferred to a "share premium account" and, that, save in stated exceptional cases the Share Premium Account must be treated in the same way as the paid-up share capital for the purposes of the rules applying to a reduction of capital: that is to say, its treatment as a revenue profit is absolutely prohibited. The exceptions referred to (in the same section of the Act) are that the share premium may be used either (1) in paying up unissued shares as fully paid bonus shares, or in writing off (2) the company's preliminary expenses or (3) commission paid or discount allowed on the issue of any of the company's shares or debentures, or (4) in providing for the premium payable on the redemption of any redeemable preference shares or debentures. The section applies to premiums on shares issued at any time before 1948 unless it had already (prior to July 1948) applied so that at that date it no longer formed an identifiable part of the company's reserves.

Entrance Fees and Subscriptions.—If the accounts under construction are those of a club or non-trading society, it will be found usually that some subscriptions have been paid in advance of the financial period. All amounts so paid in advance must be eliminated from the Income and Expenditure Account, and separately stated in the Balance Sheet as a liability. Subscriptions in arrear must be credited to Subscriptions Account, and be stated separately as an asset in the Balance Sheet. Entrance fees are usually treated as income for the period during which they are received. In strict theory, entrance fees are in the nature of capital, but by common custom they are treated as current revenue, and the examination candidate should follow this practice, if he is called upon to deal with accounts containing such items.

The student will at this stage clearly understand that the one object of all the adjustments referred to above is to ensure that the whole of the income and expenditure which has accrued during the particular financial period dealt with is included in the Trading and Profit and Loss Accounts, no matter whether the expenditure is discharged, or the income is received, or not. The section of the Profit and Loss Account dealt with above should be strictly confined to such items as affect the *actual profit or loss for the period.* All other transactions should be dealt with in the final or Appropriation Section, as explained hereafter (see pp. 66–67).

III. PROFIT AND LOSS ACCOUNTS (*continued*).

The various items dealt with above originated from actual income and expenditure received, paid, or accrued due. The balances of the ledger accounts whence these items are derived appear in the Trial Balance extracted from a set of books prior to the preparation of the Annual Accounts, or in the list of balances submitted to the examination candidate, as the case may be. But before the net profit for the period can be ascertained, certain adjustments must be made, which in the initial stage are not represented by any entries in the books or the Trial Balance. It is now necessary to consider some of these adjustments.

(*a*) CAPITAL AND REVENUE.

In the majority of instances expenditure will have occurred during the year which will require to be adjusted as between capital and revenue. Such adjustments require great care if the profit shown is to be the true profit earned. The expenditure with which such adjustments are most frequently concerned is expenditure upon such fixed assets as Buildings, Plant and Machinery, Loose Tools, Patterns, Patents, Fixtures and Fittings, and the like.

It is impossible to devise an acid test as to what is capital expenditure and what revenue expenditure. The same expenditure may be capital expenditure in some circumstances and revenue expenditure in others. Wages paid by an engineer to workmen for making a boiler to be used in his own works is capital expenditure; the same wages expended upon a boiler manufactured for sale constitute a charge against revenue. In *Accounting*, on p. 57, the present writer remarked as follows: "Broadly speaking, it may be said that expenditure which extends or enhances the earning capacity of the original equipment, and enables it to earn more income, or to work at smaller cost, is capital expenditure. All other expenditure must be charged against the revenue earned by the equipment." In other words, revenue expenditure is that which is incurred in maintaining the fixed assets of a business in efficient working order; in the conduct and administration of the business; and in the manufacture and distribution of the goods handled.

The first task of the examination candidate when confronted with a list of balances, from which a set of accounts is to be compiled, is to distinguish between the revenue (Profit and Loss) items and the capital (Balance Sheet) items. If the rules given above are applied to these items, and to the adjustments required, there should be no difficulty in discriminating between those appertaining to capital and those appertaining to revenue.

Extract from Examination Question.—Amongst the items in a list of balances the following appear, "Manufacturing Wages, £13,062; Loose Tools, £2,864." Amongst the instructions appear, "Valuation of Loose Tools at end of the year, £2,100. Manufacturing Wages (£364) were spent in making loose tools for use in the company's factory."

Solution.—In the Manufacturing Account, "Manufacturing Wages" should be stated at £13,062 − £364, *i.e.* £12,698.

"Depreciation on Loose Tools" in the Profit and Loss Account should be stated at £1,128, arrived at as follows:—

	£
Balance at beginning of the year	2,864
Add Wages paid during the year	364
	3,228
Less Valuation at end of the year	2,100
Depreciation to be charged to Profit and Loss Account	£1,128

In the Balance Sheet, the asset would appear as follows:—

	£	
Loose Tools	2,864	
Additions during the year	364	
	3,228	
Less Depreciation	1,128	£2,100

As the loose tools in question were added to the manufacturer's plant and not made for sale, the expenditure is capital expenditure. Hence the treatment illustrated above.

Hard-and-fast rules cannot, of course, be laid down. Each case must be considered on its merits, and in the light of the general rules given above.

For example, £500 has been spent upon: (*a*) repairs, (*b*) replacements, and (*c*) additions to a cigarette machine. The repairs (*a*), costing £40, were necessary owing to careless handling of the machine. The replacements (*b*), costing £60, were necessary because certain running parts of the machine failed to function properly owing to wear of the parts. The additions (*c*), costing £400, consisted of certain adjustments to the machine, by which its output of cigarettes was increased 3,000 per hour. Neither (*a*) nor (*b*) add anything to the original value of the machine. These expenditures simply keep the original machine in fair running order. Both expenditures are therefore chargeable to revenue. It is otherwise with the expenditure (*c*). Here there is an addition to the original asset by which its earning power is increased beyond its earning power when it was originally installed. The £400 spent in acquiring this added earning power may therefore be legitimately added to the capital value of the asset.

Revenue Charges in Suspense.—Adjustments may sometimes result in so heavy a charge against revenue that it is customary and legitimate to spread the expenditure over several years. A removal, perhaps, affords a good example of this treatment.

Illustration.—Blanks, Ltd., removed their factory to more commodious premises.

(*a*) The actual cost of dismantling, removing, and re-installing the plant and machinery, furniture, stock, etc., was £2,396.

(*b*) Plant and Machinery stood in the books at £10,876. One machine, standing at £500, was obsolete, and the opportunity was taken to sell it for £100 and replace it by a modern machine costing £875.

(*c*) Furniture stood at £782, and a portion of it, being unsuitable, was sold for £80, the book value of the sold portion being £125. New furniture costing £495 was purchased for the new offices.

(*d*) Fixtures and Fittings stood at £1,200, and were sold to the purchaser of the old premises for £800. New fixtures and fittings were purchased for the new factory at a cost of £1,850.

Solution.—The adjustments as between capital and revenue are as follows:—

	Capital. £	*Revenue.* £
(*a*) Removal Expenses		2,396
(*b*) Plant and Machinery—		
Loss on sale of obsolete machine		400
Cost of new machine	875	
(*c*) Furniture—		
Loss on sale of unsuitable furniture		45
Cost of new furniture	495	
(*d*) Fixtures and Fittings—		
Loss on sale of old fixtures		400
Cost of new fixtures	1,850	
	£3,220	£3,241

It may be assumed that the removal will benefit future years. It is therefore legitimate and usual to spread the revenue adjustment—in this case £3,241—over from three to five years, as in the case of preliminary expenses.

(*b*) DEPRECIATION.

Few, if any, annual accounts are prepared that do not include adjustments for the waste or depreciation that has taken place in the fixed assets employed by the business.

Definition.—Depreciation is the diminution in the utility value of an asset due to natural wear and tear, exhaustion of the subject matter, effluxion of time, accident, obsolescence, or similar causes. Wear and tear is inseparable from all working assets, and can be assessed with approximate accuracy. Depreciation due to obsolescence, fall in market value, and other outside causes is difficult to foresee or provide for. The term "depreciation" suggests waste arising from gradual deterioration rather than sudden loss or diminution in value. *Fluctuation in value* owing to "market" or other causes is not depreciation. Depreciation is a permanent diminution in value; fluctuation is temporary, and may operate to increase temporarily, as well as to diminish temporarily, the value of an asset. Although, of course, a fall or rise in market value may sometimes prove permanent. The real object of adjustments for depreciation is to distribute the original cost of wasting assets over the term of their working life. Plant and machinery and similar assets employed in earning profits gradually decrease in value through use, and the measure of this shrinkage in value is termed depreciation, and must be provided for out of revenue. A word which is increasingly coming into use in this context is AMORTIZATION. It means the provision in the accounts of a business of an amount towards the wear and tear and ultimate replacement of fixed assets. The expression first seems to have been used on the other side of the Atlantic, but has now gained a substantial footing in this country and will often be found in the published accounts of limited companies in the sense here explained.

Fluctuation in Value.—The fluctuation in value of *fixed* assets due to outside factors, *e.g.* a fall in market value of similar assets, may be ignored, since such fluctuations do not reduce the earning power of the assets. Fixed assets are not held for sale, but to earn revenue, and their value to a going concern is not affected by market fluctuations in their value. Fluctuations in the value of *floating* assets, *e.g.* stock, may also be ignored if they are temporary fluctuations. But if the fall in value appears to be permanent, stock or other floating assets must be written down to the level of current market prices.

Provision for Depreciation Essential.—The author has heard manufacturers say in a year of lean profits that they "cannot afford to allow for depreciation this year." This attitude is quite unsound. The depreciation that should be allowed for bears no relation to the gross profits made for the year. The depreciation has actually occurred. It is a part of the cost of production and must be provided for no matter what gross profits or losses are shown by the Trading Account, otherwise the net profits or losses shown by the Profit and Loss Account and the balance of the manufacturer's capital account will be inaccurate.

Illustration.—Blanks, Ltd., purchased a cigarette machine for £1,200. Its probable life was estimated to be five years, at the end of which time its scrap value would be £100. If no depreciation is written off the machine, it will appear in the books when sold as of a value of £1,100 (*i.e.* £1,200, the original cost, less £100 the proceeds of sale as scrap). Clearly this wastage of £1,100 should have been spread over the life of the machine. Broadly speaking, Blanks, Ltd., paid £1,100 in advance for the work the machine was going to do in the five years. Each year of the five should therefore have borne its due proportion of the £1,100. Roughly, the waste is £220 per annum, and if this sum had been debited to Profit and Loss Account and credited to Cigarette Machine Account each year, the asset account would have been eliminated at the end of the five years when the machine was sold for £100.

Depreciation must be credited to the asset account in question, and debited either to a Depreciation Account or (by a short cut) to Profit and Loss Account. The transfer may be either direct or through the Journal: theoretically, the use of the Journal is desirable, but it is not strictly necessary. If the Journal is used the entries will be on the following lines:—

JOURNAL.

		£	s.	d.	£	s.	d.
19... Dec. 31	Depreciation Account . . . . . Dr.	371	0	0			
	To Machinery and Plant (10%)				200	0	0
	Loose Tools (as per valuation) . . .				151	0	0
	Furniture (5%)				20	0	0
	For depreciation for the year ended December 31, 19...						
" 31	Profit and Loss Account . . . . . Dr.	371	0	0			
	To Depreciation Account				371	0	0
	Transfer of balance.						

In this manner, a comprehensive record is available for reference in future years. Examination candidates frequently omit one side of the depreciation entries, and the few minutes occupied in journalising them as above will ensure correct treatment, and is time well spent.

Methods of Assessing Depreciation.—The assessment of depreciation must of necessity be based upon *estimate*. There is no room here for dogmatism, and tables of fixed rates of depreciation designed for every trade and asset are worthless. Each case must be judged on its merits and in the light of all the circumstances.

The accountant's task is: (*a*) To assess as closely as possible the money equivalent of the depreciation that will take place during the life of the asset, and (*b*) to distribute this assessment equitably over the working life of the asset.

In order to do this the following *data* are necessary: (*a*) The original cost of the asset, (*b*) the interest on the capital cost, (*c*) the probable working life of the asset as employed (some machines may stand idle for long periods, others may be worked both day and night), (*d*) its scrap value at the close of its useful life, (*e*) the degree to which it is liable to become obsolete, (*f*) whether the asset will be maintained in efficient repair. The answers to (*c*), (*d*), (*e*), and (*f*) will be supplied by the technical experts.

When the amount of the depreciation to be provided for has been assessed, five methods are commonly employed for its distribution over the life of the asset. These are: (1) The straight-line, or equal-instalment, method; (2) the diminishing-balance method; (3) the annuity method; (4) the sinking-fund method; (5) the insurance policy method. Occasionally a sixth method—*i.e.* valuation—is employed. Where a costing system is in operation, or the necessary statistics are otherwise available, other methods, based on output, machine hours, efficiency hours, etc., are sometimes employed.

(1) **The Straight-Line Method.**—By this method, which is also known not infrequently as the "fixed-instalment" method, the original or present value of the asset is divided by the number of years of its estimated "useful" or "working" life, and an equal part of the cost is debited each year of the life to revenue, repairs and renewals of the asset also being charged to revenue. If the scrap value of the asset at the close of its life can be estimated, this sum is deducted from the original cost before the annual instalments chargeable to revenue are computed. Thus, if the original cost of a machine be £2,000, its estimated working life be ten years, and its scrap value at the end be £200, then the amount to be charged to revenue is £2,000 − £200 = £1,800, or £180 per annum under the straight-line method. If additions are made to the asset during its life, they must be treated in a similar way, and be spread over the remainder of the period in equal instalments. The Institute of Chartered Accountants has officially recommended to its members that this method is the most appropriate one to use in most cases.

The advantages claimed for it are: (*a*) its simplicity, and (*b*) the fact that the asset is completely eliminated at the close of its life. Objections sometimes urged against the method are: (*a*) that additions to an asset so treated cause changes in the asset account, and consequently fresh calculations of the depreciation charge become necessary; (*b*) the question of interest is ignored; and (*c*) the burden of repairs falls more heavily on the later than the earlier years of the life of the asset. As to (*c*), experience proves that in the case of a large plant employing machines of all ages, the system works satisfactorily, since the heavier repairs on the older machines are counterbalanced by the lighter repairs on the newer.

This method is frequently applied to short leases and similar short-lived assets, all repairs being charged to revenue.

Illustration.—A cigarette-boxing machine costs £1,400. The life of the machine is six years. The scrap is £200. The amount to be spread over the period is, therefore, £1,200, or £200 per annum.

CIGARETTE-BOXING MACHINE.

Dr.	£ s. d.	Cr.	£ s. d.
To Original Cost	1,400 0 0	By Depreciation Account (annual instalment)	200 0 0
		,, Balance carried down	1,200 0 0
	£1,400 0 0		£1,400 0 0
To Balance brought down	1,200 0 0		

(2) **The Diminishing Balance Method.**—By this method, a fixed percentage, *e.g.* 10%, is written off the diminishing balance of the asset

account every year. If this method is adopted, care must be taken that the percentage rate employed is sufficiently high to allow of the asset being eliminated at the close of its life.

The chief advantage claimed for this method is that the revenue charge is equitably averaged, inasmuch as, in the early years, when the machine is new, the depreciation charge is heavy and the repair and maintenance charge light, whereas, in the later years, when the repair and maintenance charge is heavy, the depreciation charge is light.

Experience shows that this is probably the most popular method with business men. The difficulty is to induce them to adopt a percentage high enough to reduce the asset to its scrap value at the close of its working life.

Examination candidates appear to experience difficulty when a Trial Balance contains an asset account (commencing balance) with additions during the year, and also instructions that depreciation is to be provided at a given rate. In the absence of instructions to the contrary, the candidate should provide for depreciation at the given rate on the total *final* debit of the asset account.

Illustration.—Machinery and Plant, £12,950; Additions during the year, £479. The company's workmen were paid £121 wages in installing the additions to the Machinery and Plant. Depreciation at 10% is to be written off Machinery and Plant. (Extracted from an Examination Trial Balance.)

Solution.

MACHINERY AND PLANT ACCOUNT.

Dr. Cr.

	£	s.	d.		£	s.	d.
To Balance . . .	12,950	0	0				
„ Additions during the year . . .	479	0	0				
„ Transfer from Wages Account . .	121	0	0				
	£13,550	0	0				

Ten per cent. depreciation on £13,550, *i.e.* £1,355 should be debited to Profit and Loss Account, and the asset be shown in the Balance Sheet as follows:—

	£	£
Machinery and Plant	12,950	
Additions during the year	600	
	13,550	
Less Depreciation	1,355	
		£12,195

In actual practice, additions may be made so late in the financial period covered by the accounts that provision for depreciation may be considered unnecessary. In any case, additions create no difficulty, since depreciation of them can be adjusted to the date when they were made, and the needs of the case. In the great majority of cases, depreciation is written off the *final* balance of the asset account as shown in the above illustration.

In examination questions, where additions to an asset are included in the Trial Balance, and a general rate is named for the depreciation, the candidate is sometimes informed in the "Instructions" following the Trial Balance that the average date of the additions was, *e.g.* September 30. This indicates that the rate of depreciation named is to be based upon this average date. Where the financial period dealt with by the accounts covers a year ending at December 31, this means that the additions are to be depreciated at the rate named, but for three months instead of the whole of the year.

The student will realise that whereas a fixed depreciation percentage charged each year upon the *original cost*, as in the straight-line method, will eliminate the asset during its life, the same percentage as employed by the diminishing-balance method will leave a considerable balance on the books at the end of the life of the asset. For example, a machine costing £1,000 and possessing no scrap value, having an estimated life of five years, would, on a 20% basis of depreciation, be eliminated as an asset at the end of the five years, but, if it were depreciated at the rate of 20% on the diminishing balance, the asset would stand in the books as of a value of £327 13s. 7*d.* at the close of the period. An asset depreciated at the rate of 10% on the diminishing annual balance will have a book value of over 35% of its original cost at the end of 10 years, 12% after 20 years, 4% after 30 years, and 1% after 43 years. It is not always easy to convince business men of this difference between the two methods.

(3) **The Annuity Method.**—It is assumed by this method that the capital sunk in the purchase of the asset is earning interest. The annual depreciation charge is ascertained from Tables, and is calculated so as to eliminate the asset, *together with interest on the capital sunk*, at the close of the life of the asset. Interest on the capital sunk, at the agreed rate, is debited to the asset account and credited to revenue each year. This theory assumes that the capital expended on the asset earns the interest credited to revenue in each financial period. The interest taken credit for decreases automatically as the depreciation charge reduces the book value of the asset. The depreciation charge is constant. It is clear, therefore, that revenue bears a gradually increasing burden. This is probably the most scientific system, but it is not popular with the commercial community. An objection to the method is that when additions are made to the Asset Account revised calculations must be made, and, particularly also, that, in the early years, the book value of the asset may be in excess of its real value.

By this method, the asset account will appear as follows:—

ASSET ACCOUNT.

Dr.	£ s. d.	Cr.	£ s. d.
To Original Cost	1,200 0 0	By Profit and Loss Account, being annual depreciation charge as per actuarial tables for five years	277 3 4
" Transfer to Profit and Loss Account, being interest at 5%	60 0 0	" Balance carried down	952 16 8
	£1,260 0 0		£1,260 0 0
To Balance brought down	952 16 8		

If preferred, the transfer of interest may be made to the credit c Interest Account, and thence, in due course, to the Profit and Los Account.

(4) **The Sinking Fund Method.**—This method also takes int account the question of interest. A fixed amount is charged each yea to revenue, and at the same time an equivalent amount of cash : separately invested. The annual instalment represents the amour which, invested at compound interest, will, at the close of the perioc realise a sum equal to the original cost of the asset. The asset remair in the books at its original cost until the close of its life, when the sinl ing fund is used to eliminate it. The advantage of this method is tha it provides the actual cash wherewith to replace the asset.

The records of a sinking fund invested in Stock Exchange securitie (Arcadia 5% Gold Bonds at par) are as follows:—

SINKING FUND.

Dr. Cr.

Year.		£	s.	d.	Year.		£	s.
1	To Balance carried down	1,000	0	0	1	By Profit and Loss Account . . .	1,000	0
2	To Balance carried down	2,050	0	0	2	By Balance brought down	1,000	0
						„ Profit and Loss Account . . .	1,000	0
						„ Interest . . .	50	0
		£2,050	0	0			£2,050	0
3	To Balance carried down	3,152	10	0	3	By Balance brought down	2,050	0
						„ Profit and Loss Account . . .	1,000	0
						„ Interest . . .	102	10
		£3,152	10	0			£3,152	10
					4	By Balance brought down	3,152	10

INVESTMENT OF SINKING FUND.

(Arcadia 5% Gold Bonds.)

Dr. Cr.

Year.		£	s.	d.		£	s.
1	To Cash . . .	1,000	0	0			
2	„ Cash . . .	1,050	0	0			
3	„ Cash . . .	1,102	10	0			
		£3,152	10	0			

Note.—In practice, the investment of the cash instalment and the re-inves ment of the interest may not take place until after the end of each year, so th: on the Balance Sheet the amount of the Sinking Fund may appear greater tha the amount of the Investment. The cash instalment for the last year and tl interest would not be re-invested, but, with the proceeds of the sale of the inves ment, would form the fund available for the purchase of the new asset.

(5) **The Insurance Policy Method.**—This is another form of sinkir fund. A capital endowment policy is taken out with an Assuranc Company for the amount necessary to replace the asset, maturing ; the close of the life of the asset. The advantage of this method is, ;

compared with the sinking-fund method, that the *exact* sum required will be forthcoming when the asset is to be replaced, whereas a sinking fund invested in Stock Exchange securities may, owing to market fluctuations in the stock selected for investment, result in a deficiency at the required date. Again, a sinking fund, by pressure of circumstances, may be diverted from its original purpose.

The normal method of book-keeping employed is to open two accounts. The first, to which all the premiums paid are debited, is the Policy Account. The second, the credit side of which are posted the annual transfers from profit and loss is the Sinking Fund or Redemption Account. The balances on these two accounts will always be equal in amount, but on opposite sides. It is usual, but not obligatory, to maintain the policy account at either cost (the total of premiums paid) or surrender value, whichever is the *greater*. In most cases it will be found that in the first few years the surrender value is less than the total of the premiums paid to date, but after a period the surrender value (by reason of accumulating interest) begins to exceed the total of the premiums by larger and larger amounts. As soon as this happens the policy account is written up to correspond, the transfer being to the credit of Sinking Fund Account. It will be noted that under this method (and the same normally applies to the Sinking Fund Method described under (4) above) the total of the transfers from profit and loss is equal to the total of the premiums paid (amounts invested), and since this last total is practically always less than the capital amount for which the policy is taken out (the proceeds of the investments) which in turn is equal to the cost of the asset to be replaced. The total of the charges against profit is less than the cost of the asset. The difference, of course, represents interest receivable over the period but not credited to profit and loss as such: actually this interest has been applied indirectly in reduction of the charges against profit.

In the illustration it is assumed that:—

(*a*) the annual premium is £100 payable annually on January 1;

(*b*) for the first three years the surrender value is less than the total of premiums paid to date; and

(*c*) at the end of the fourth year the surrender value of the policy is £403 and at the end of the fifth year £525.

ENDOWMENT POLICY ACCOUNT.

(DEBIT SIDE ONLY.)

Year.	Date.		£	s.	d.
1	Jan. 1	To Cash (Premium)	100	0	0
2	Jan. 1	To Cash (Premium)	100	0	0
			200	0	0
3	Jan. 1	To Cash	100	0	0
			300	0	0
4	Jan. 1	To Cash	100	0	0
	Dec. 31	,, Redemption Account	3	0	0
			403	0	0
5	Jan. 1	To Cash	100	0	0
	Dec. 31	,, Redemption Account	22	0	0
			£525	0	0

ASSET REDEMPTION ACCOUNT.

(CREDIT SIDE ONLY.)

Year.	Date.		£	s.	d.
1	Dec. 31	By Profit and Loss Account . .	100	0	0
2	Dec. 31	By Profit and Loss Account . .	100	0	0
			200	0	0
3	Dec. 31	By Profit and Loss Account . .	100	0	0
			300	0	0
4	Dec. 31	By Profit and Loss Account . .	100	0	0
		,, Policy Account	3	0	0
			403	0	0
5	Dec. 31	By Profit and Loss Account . .	100	0	0
		,, Policy Account	22	0	0
			£525	0	0

(6) **Valuation Method.**—Sometimes, depreciation is determined by the process of actual re-valuation of the asset at the close of each financial period. In any case, such valuations, where practicable, are valuable as a periodical check upon book values arrived at by ordinary depreciation methods. This method is not suitable for heavy fixed assets such as buildings and the like. Indeed, in unscrupulous hands, the method might become dangerous, in addition to being costly. But some assets are particularly suitable for re-valuation, *e.g.* loose tools, copyrights, patents, horses, cattle, sacks, cases, casks, bottles, etc. The difference between the book value of assets and the valuation is treated as depreciation and written off accordingly. Should the valuation disclose an appreciation in value, it is wise for book-keeping purposes to ignore the appreciation.

Examination questions frequently indicate that the depreciation on certain assets is to be based on a valuation, particulars of which are given, as already explained at pp. 25–26.

Depreciation Provisions—Limited Companies.—Until quite recently (this is written in 1949) it has been the almost universal practice (except under the " double-account system ") to credit any depreciation to the asset account concerned, so that the debit balance on that account, which has been diminished by the amount of depreciation in question, represents the net " going-concern " value of the asset. In view, however, of the requirement of the Companies Act, 1948, that balance sheets should now disclose the cost of fixed assets, together with aggregate depreciation, it can be seen that, so far at any rate as limited companies are concerned, the old method is inconvenient and must be superseded. Admittedly, if the books are methodically kept it should in theory be possible to derive from them the necessary figures of cost and aggregate depreciation, but except in the case of a new business the ascertainment of these figures may be a long and laborious undertaking, and if there have been sales of a portion of the fixed assets the difficulty will be increased. It is therefore advocated that henceforward the records of all fixed assets should be maintained in the books permanently at cost, so long as the assets are in existence.

depreciation provisions being credited to a separate account in which they accumulate as a credit balance which tends to increase year by year. If properly kept, these two accounts, the Asset Account on the one hand and the Accumulated Depreciation Account on the other, will at once give directly the particulars required to be disclosed in the balance sheet.

While, for the reason stated, this method is now necessary as regards limited companies, it is clear that in any event it gives more information than the old method, and is on that account to be preferred to all cases. The author suggests therefore that unless there are objections or difficulties in particular cases the new method may with advantage be adopted even in the books of partnerships and sole traders.

In practice, the method offers no difficulties until an asset is sold or scrapped. When that happens an adjustment becomes necessary: the cost of the asset sold must be credited to the Asset Account and debited to the Depreciation Account. If the proceeds of sale are credited to the Depreciation Account and if, further, the proceeds of sale happen (which will obviously be rare in practice) to be equal to the net value of the asset in the books, that will be the end of the matter: the existing accumulated depreciation added to the proceeds of sale are together equal to the cost, so the debit and credit entries cancel out and no balance relating to the asset sold remains in the books. In other cases there will be a debit or credit balance remaining which will represent a loss or profit on sale, as the case may be. This may, if thought fit, be transferred to Profit and Loss Account: if no such transfer is made, the effect is to decrease or increase, according to the circumstances, the balance which remains standing on the Depreciation Account. It can readily be seen, for instance, that if there is actually a profit on sale which is allowed to stand on the Depreciation Account this is equivalent to treating such profit as a depreciation provision applicable to the remaining (unsold) assets, but not provided (or only indirectly) by a charge against revenue. Such treatment apparently does not conflict with the Companies Act (see the Eighth Schedule, para. 7 (1), which excepts provisions for depreciation from the requirement to disclose the source of annual variations of reserves and provisions unless such variations are disclosed in the Profit and Loss Account), but if the amount involved is large the result might be misleading if the reason is not disclosed. It is clear, on the other hand, that if a substantial loss on sale is debited to the Depreciation Account the result may be to make the resultant aggregate provision too small, so that a further provision, charged to profit and loss, will be necessary in addition to the normal provision for the year. In effect, therefore, the year's total provision would include the loss on sale, and it would be more informative to disclose the fact.

If it is a case where the original cost of the assets is not ascertainable, so that the alternative "net book value" method permitted by the Act has to be adopted, then the "net book value" (as on June 30, 1948, or earlier accounting date applicable) will be the amount to stand permanently in the books in the same way as would the cost had that been known. In this case only the depreciation provided since June 30, 1948 (or earlier date), would be accumulated as a credit balance.

In such a case, *i.e.* where there are assets recorded at "net book value," it is most advisable to keep such assets in one account, and assets purchased later (to be shown of course at cost) in a separate account: failure to do so will most likely lead to difficulties and confusion later. Further, it is advisable, as a further refinement, to maintain also two separate depreciation accounts, one to record depreciation provided in respect of the "net book value" assets and the other depreciation provided in respect of the assets shown at cost.

The only point still remaining to make is that it is highly advisable, in all cases, to keep detailed inventories of all fixed assets, showing at least the cost and date of purchase of each item: if this is not done difficulties will arise, whenever a sale or scrapping takes place, in discovering the amount to credit to the "aggregate asset" account. As regards plant, the "plant register," if kept, serves the purpose: registers of furniture and fittings, however, have, in the past, been the exception rather than the rule in the author's experience: accountants are apt to plead that the trouble of keeping such registers is not justified by the advantages gained. As regards limited companies, at any rate, this plea is no longer valid, the keeping of registers now obviously leads to the saving of trouble rather than the creating of it.

We proceed to consider a few examples:—

Illustration 1.—In 1951 Hacketts, Ltd., bought six motor lorries for £320 each. Depreciation was provided at 10% in the first year and 20% on the written-down value in each subsequent year. Two of the lorries were sold for £350 in 1955.

The depreciation and written-down values are:—

	Depreciation. £	*Written-down value.* £
1951	192	1,728
1952	346	1,382
1953	276	1,106
1954	221	885
1955 book value of two lorries sold		295
Leaving four lorries, valued as on Dec. 31, 1954		590
1955	118	472
1956	94	378

It is assumed that the profit on sale has been transferred to profit and loss (or to a reserve). The entries in the books will be:—

MOTOR LORRIES (AT COST).

Dr. Cr.

		£	s.	d.			£	s.	d.
1951	To Cash	1,920	0	0	1955	By Depreciation Account	640	0	0
					,,	,, Balance carried down	1,280	0	0
		£1,920	0	0			£1,920	0	0
1956	To Balance brought down	£1,280	0	0					

MOTOR LORRIES—ACCUMULATED DEPRECIATION.

Dr. Cr.

		£	s.	d.			£	s.	d.
					1951	By Profit and Loss Account . .	192	0	0
					1952	By Profit and Loss Account . .	346	0	0
							538	0	0
					1953	By Profit and Loss Account .	276	0	0
							814	0	0
					1954	By Profit and Loss Account . .	221	0	0
							1,035	0	0
1955	To Motor Lorries Account (two sold at cost) . . .	640	0	0	1955	By Cash . . .	350	0	0
	" Profit on sale (to Profit and Loss Account) . .	55	0	0		" Profit and Loss Account . .	118	0	0
	" Balance carried down . .	808	0	0					
		£1,503	0	0			£1,503	0	0
					1956	By Balance brought down . .	808	0	0
						" Profit and Loss Account . .	94	0	0
							902	0	0

The balance sheet entry at the end of 1956 would accordingly be :—

	£	£
Motor Lorries, at cost	1,280	
Less Aggregate Depreciation	902	
		£378

Illustration 2.—Charlton, Ltd., owns plant and machinery subject to varying rates of depreciation, full details being recorded in a plant register. The cost of the plant on hand on January 1, 1951, was £37,700. In 1952 fresh plant was bought at a cost of £3,600, and in 1953 old plant was scrapped as useless, the scrap being sold for a figure equal to the cost of dismantling. The cost of the plant sold was £2,300, and the same amount had been provided as total depreciation in respect of it. The aggregate depreciation provided up to 1950 on all plant was £13,200, and further depreciation was provided as follows : 1951, £2,900 ; 1952, £3,200 ; 1953, £3,100.

The ledger accounts will be :—

PLANT ACCOUNT (AT COST).

Dr. Cr.

		£	s.	d.			£	s.	d.
1950	To Balance . .	37,700	0	0					
1952	To Cash . . .	3,600	0	0					
		41,300	0	0	1953	By Depreciation Account .	2,300	0	0
						" Balance carried down . .	39,000	0	0
		£41,300	0	0			£41,300	0	0
1954	To Balance brought down . .	£39,000	0	0					

PLANT—ACCUMULATED DEPRECIATION.

Dr.									Cr.
		£	s.	d.			£	s.	d.
					1950	By Balance . .	13,200	0	0
					1951	By Profit and Loss Account . .	2,900	0	0
							16,100	0	0
					1952	By Profit and Loss Account . .	3,200	0	0
							19,300	0	0
1953	To Plant Account .	2,300	0	0	1953	By Profit and Loss Account . .	3,100	0	0
	,, Balance carried down . .	20,100	0	0					
		£22,400	0	0			£22,400	0	0
					1954	By Balance brought down . .	£20,100	0	0

Illustration 3.—Verona, Ltd., who prepare accounts annually to March 31, own a freehold factory, the written-down value of which as on March 31, 1948, was £23,500. Examination of past records showed that the original cost was £28,000. In 1951 the factory was enlarged at a cost of £12,500, of which £300 was estimated to represent the cost of dismantling and adapting a portion of the original factory. The original cost of the portion dismantled was estimated at £800.

Revenue was charged with £200 per annum by way of depreciation in each year from March 1949 to March 1951, and £300 per annum thereafter. The ledger accounts would be :—

FREEHOLD FACTORY.

Dr.									Cr.
		£	s.	d.			£	s.	d.
1948 ar. 31	To Balance (net book value) . .	23,500	0	0					
1949. ar. 31	To Accumulated Depreciation . .	4,500	0	0					
		28,000	0	0					
1951.	To Cash . . .	12,500	0	0	1951. Mar. 31	By Accumulated Depreciation * .	1,100	0	0
					1952. Mar. 31	By Balance carried down . .	39,400	0	0
		£40,500	0	0			£40,500	0	0
1952. ar. 31	To Balance brought down . .	£39,400	0	0					

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* Of the £1,100 transferred, £300 is included in the £12,500 spent in 1951, but does not represent an ddition to the building, while £800 represents part of the original expenditure of £23,500 which no longer xists. It is assumed that the annual charge to revenue is considered adequate to cover these losses.

FREEHOLD FACTORY—ACCUMULATED DEPRECIATION.

Dr.		£	s.	d.		Cr.	£	s.	d.
					1949. Mar. 31	By Factory Account .	4,500	0	0
						" Profit and Loss Account . .	200	0	0
							4,700	0	0
					1950. Mar. 31	By Profit and Loss Account . .	200	0	0
							4,900	0	0
1951. Mar. 31	To Factory Account .	1,100	0	0	1951. Mar. 31	By Profit and Loss Account . .	200	0	0
							5,100	0	0
1952. Mar. 31	To Balance carried down . .	4,300	0	0	1952. Mar. 31	By Profit and Loss Account . .	300	0	0
							5,400	0	0
		£5,400	0	0			£5,400	0	0
					1952. Mar. 31	By Balance brought down . .	£4,300	0	0

Illustration 4.—Muiden, Ltd., prepares accounts annually to June 30. The company, which has been in existence for many years, is unable to ascertain the original cost of its furniture and fittings, the written-down value of which as on June 30, 1948, was £1,560. During the year to June 30, 1949, new furniture was bought at a cost of £300, and during the year to June 30, 1950, further furniture at a cost of £400, and (in the same year) old furniture bought before 1948 was sold for £90.

It was decided to write off all the "pre-1948" furniture by equal instalments over ten years and to provide depreciation in respect of all subsequent additions at 5% per annum on cost.

The ledger accounts will be as follows :—

FURNITURE ETC. (AT NET BOOK VALUE).

Dr.		£	s.	d.		Cr.	£	s.	d.
1948. June 30	To Balance brought forward . .	£1,560	0	0	1950. June 30	By Cash . . .	90	0	0
						" Balance carried forward . .	1,470	0	0
		£1,560	0	0			£1,560	0	0

FURNITURE AND FITTINGS (AT COST).

Dr.		£	s.	d.		Cr.	£	s.	d.
1949. June 30	To Cash	300	0	0					
1950. June 30	To Cash	400	0	0					
		£700	0	0					

ACCUMULATED DEPRECIATION (ON OLD FURNITURE).

DR. £	s.	d.			CR. £	s.	d.
			1949. June 30	By Profit and Loss Account . .	156	0	0
			1950. June 30	By Profit and Loss Account ($\frac{1}{9}$ of £1,470 *less* £156)	146	0	0
					302	0	0
			1951. June 30	By Profit and Loss Account ($\frac{1}{9}$ of £1,470 *less* £156)	146	0	0
					£448	0	0

ACCUMULATED DEPRECIATION (ON NEW FURNITURE).

DR. £	s.	d.			CR. £	s.	d.
			1949. June 30	By Profit and Loss Account . .	15	0	0
			1950. June 30	By Profit and Loss Account . .	35	0	0
					£50	0	0

Provision for Waste—Legal and Commercial Views.—The necessity for providing for all waste and depreciation preliminary to the ascertainment and distribution of net profits is unlikely to be questioned by the sound business man. But it cannot be said that this necessity is in all cases a matter of legal obligation. A series of legal decisions, of abiding interest to accountants, beginning with *Lee* v. *Neuchatel Co., Ltd.* (1889), is dealt with at some length in the author's *Accounting*, pp. 320–327, and to those pages the student is referred, since to reproduce them here would be to occupy space that can ill be spared in this treatise. Study of these decisions will convince the student that, though from the legal point of view it is not always incumbent upon directors to provide for depreciation in wasting assets prior to the distribution of profits, he will be unwise to go further, as he sometimes does, and generalise that, legally, provision for waste is unnecessary. It is suggested that the most that can be inferred from the judgments in question is that, in any particular case, the Court will decide whether provision for waste is or is not necessary after taking into full consideration the particular circumstances of the case. Depreciation in current assets must be made good. But, in certain circumstances, the Court has refused to compel directors to make good waste in *fixed* assets prior to the distribution of dividends, and has also refused to compel directors to pay dividends where they deemed it desirable to retain the balance standing to the credit of Profit and Loss Account for the purpose of making good waste in fixed assets.

It would appear from the cases referred to above the Court is primarily concerned with the protection of creditors. A limited company is, however, also concerned with the rights of its shareholders and the preservation of its capital. Hence the wise practice followed by

ENDOWMENT POLICY ACCOUNT.

Dr. Cr.

Year.		£	s.	d.	Year.		£	s.	
1 (Jan. 1)	To Cash (Premium) .	100	0	0	1 (Dec. 31)	By Balance carried down, being surrender value at date . .	10	0	0
					1	„ Asset Redemption Account . .	90	0	0
		£100	0	0			£100	0	0
2	To Balance brought down . .	10	0	0	2	By Balance carried down, being surrender value at date . .	25	0	0
2	„ Cash (Premium) .	100	0	0	2	„ Asset Redemption Account . .	85	0	0
		£110	0	0			£110	0	0
3	To Balance brought down . .	25	0	0	3	By Balance carried down, being surrender value at date . .	309	0	0
3	„ Cash (Premium) .	100	0	0					
3	„ Asset Redemption Account . .	184	0	0					
		£309	0	0			£309	0	0
4	To Balance brought down . .	309	0	0					

ASSET REDEMPTION ACCOUNT.

Dr. Cr.

Year.		£	s.	d.	Year.		£	s.	d.
1 (Dec. 31)	To Policy Account .	90	0	0	1 (Dec. 31)	By Profit and Loss Account . .	100	0	0
1	„ Balance carried down . .	10	0	0					
		£100	0	0			£100	0	0
2	To Policy Account .	85	0	0	2	By Balance brought down . .	10	0	0
2	„ Balance carried down . .	25	0	0	2	„ Profit and Loss Account . .	100	0	0
		£110	0	0			£110	0	0
3	To Balance carried down . .	309	0	0	3	By Balance brought down . .	25	0	0
					3	„ Profit and Loss Account . .	100	0	0
					3	„ Policy Account .	184	0	0
		£309	0	0			£309	0	0
					4	By Balance brought down . .	309	0	0

directors, and by the business community generally, of creating reserves for all known wastage and contingencies.

(c) SINKING FUNDS.

The provisions for waste dealt with hitherto are *charges against profits or costs of production*. Certain other provisions sometimes become necessary, which are *appropriations out of profits* rather than charges against profits, such, for instance, as provisions made to meet accruing liabilities. These are made by means of *Sinking Funds.*

Definition.—The term "Sinking Fund" was first used to denote moneys set aside by the Treasury for the reduction and ultimate extinction of the National Debt—*to sink the National Debt.* It has now been widely adopted by the commercial world. A sinking fund may be defined as a fund created by means of periodical instalments invested in securities, and accumulated at compound interest. The object of such funds is to provide a definite capital sum at a definite date wherewith either: (*a*) to redeem a liability or (*b*) to replace an asset. The chief advantage of these funds is that they avoid the heavy strain on the working capital of an undertaking which would result if a large sum of money had suddenly to be withdrawn from the business. Students sometimes confuse sinking funds with reserves. A reserve may be either general or for a specific purpose: if ultimately not required, it may be transferred back to the credit of Profit and Loss. A sinking fund, on the other hand, is by its nature specific, and can be used only for the purpose for which it is designed.

Creation of Sinking Fund.—Sinking funds are built up by equal yearly or other periodical instalments, which, placed on fixed deposit with a bank, or invested in sound securities, will, with the interest earned, similarly placed on deposit or invested in the securities selected, provide the definite capital sum on the definite date required. The instalments are not a charge against profits, but they cannot be paid except out of profits. It is clear that when the cash instalments are withdrawn from the business and placed on deposit or invested, the transactions are merely a change from one type of asset to another. But the change of assets deprives the company of the power to distribute as dividends that portion of the profits so withdrawn. That being so, it is the usual practice to debit the Appropriation Section of the Profit and Loss Account with the instalments so withdrawn, and to credit the withdrawals to a Sinking Fund Account. The balance of the Sinking Fund Account at any time represents the total profits set aside. If this practice is not followed, the result will be that a gradually increasing balance will be carried forward on the Profit and Loss Account from year to year, although the balance is not available for distribution in cash.

Instalment Calculation.—The amount of the periodical instalment to be set aside is based upon the following considerations: (*a*) the amount of the capital sum to be provided; (*b*) the date when the fund will be required; (*c*) the rate of compound interest expected to be realised on the instalments invested. On these data, any standard book of tables will show the amount of the annual instalment required.

Illustration.—Z, Ltd., issued £55,000 fifteen-year notes. What is the amount of the annual instalment to provide a Sinking Fund for their redemption, assuming that the Sinking Fund investments will earn 4% per annum?

From interest tables it is found that the amount of an annuity of £1 per annum payable at the *end* of each year for fifteen years at 4% is £20·0235876. Thus the amount required to accumulate £55,000 is :—

£55,000 ÷ 20·0235876 = £2,746 15*s*.

Uses of Sinking Funds.—It has already been shown that by various methods the wastage of an asset is provided for by depreciation charged in the Profit and Loss Account. Such processes are designed to eliminate the asset from the books at the close of its life, but they do not provide the money wherewith to replace the asset. Hence the advantage of a sinking fund that actually, when the need arises, provides the capital sum by which such assets as Plant and Machinery, Leases, Buildings, Mining Rights, and the like can be replaced. A sinking fund is equally useful to provide funds to meet at maturity such liabilities as Debentures, Loans, Bonds, Dilapidations under a Lease, the loss on Terminable Securities purchased at a premium, etc.

SINKING FUND ACCOUNT.

For the Redemption of £12,000 7% Bonds repayable January 1, 1954.

Dr. Cr.

		£	s.	d.			£	s.	d.
1954. Jan. 1	To General Reserve Account . .	12,000	0	0	1950. Dec. 31	By Profit and Loss Appropriation Account . .	2,784	2	10
					1933. Dec. 31	By Cash, Interest .	139	4	2
					„ 31	„ Profit and Loss Appropriation Account . .	2,784	2	10
					1934. Dec. 31	By Cash, Interest .	285	7	6
					„ 31	„ Profit and Loss Appropriation Account . .	2,784	2	10
					1935. Dec. 31	By Cash, Interest .	438	17	0
					„ 31	„ Profit and Loss Appropriation Account . .	2,784	2	10
		£12,000	0	0			£12,000	0	0

SINKING FUND INVESTMENT ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
1950. Dec. 31	To Cash, Instalment .	2,784	2	10	1951. Dec. 31	By Balance carried down . .	5,707	9	10
1951. Dec. 31	To Cash, One year's interest re-invested	139	4	2					
„ 31	„ Cash, Instalment .	2,784	2	10					
		£5,707	9	10			£5,707	9	10
1952. Jan. 1	To Balance brought down . .	5,707	0	0	1952. Dec. 31	By Balance carried down . .	8,777	0	2
Dec. 31	„ Cash, Interest re-invested . .	285	7	6					
„ 31	„ Cash, Instalment .	2,784	2	10					
		£8,777	0	2			£8,777	0	2
1953. Jan. 1	To Balance brought down . .	8,777	0	2	1953. Dec. 31	By Cash, Proceeds of sale of investments . .	12,000	0	0
Dec. 31	„ Cash, Interest * .	438	17	0					
„ 31	„ Cash, Instalment * .	2,784	2	10					
		£12,000	0	0			£12,000	0	0

* In practice these two amounts would not be invested.

7% BONDS ACCOUNT.

REPAYABLE AT PAR, JANUARY 1, 1954.

Dr. Cr.

		£	s.	d.			£	s.	d.
1954. Jan. 1	To Cash, Repayment .	12,000	0	0	1950. Jan. 1	By Cash on Issue .	12,000	0	0

GENERAL RESERVE ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
					1954. Jan. 1	By Sinking Fund Account . .	12,000	0	0

The above illustration shows the working of a sinking fund created to redeem a liability. The contributions to the fund are assumed to have been invested in gilt-edged securities producing 5%.

Sinking Funds Contrasted.—It may be well again to remind the student of the difference between a sinking fund created to redeem a liability, and one created to replace an asset.

(a) *Redemption of Liability.*—In this case, the instalments are not a charge against profits but *appropriations* of profits. But since cash has been taken out of the business, it is necessary to reserve an equivalent amount of profit. If the profits were divided " up to the hilt " without appropriating the Sinking Fund instalment each year, the business would be drained of working capital.

When a sinking-fund operation matures, and the investments have been realised, and the liability paid off, it is clear that the liability account and the investment account cancel each other and disappear from the Balance Sheet. There remains the Sinking Fund Account, built up by the annual appropriations from Profit and Loss Account. That account now constitutes a general reserve, created out of undivided profits, and should be transferred to General Reserve Account.

(b) *Replacement of an Asset.*—Here, the instalments represent the wastage of an asset, and are charges against revenue, since they take the place of depreciation. The book value of the asset remains undisturbed until, at the close of its life, the asset account is eliminated by the transfer thereto of the Sinking Fund Account. The new asset to replace the old is purchased with the funds made available by the realisation of the sinking-fund investments, and a new asset account is opened in the ledger.

Redeemable Preference Shares.—Where such shares have been issued and it is intended to redeem them out of profits, it is a wise precaution to appropriate profits year by year over the period from the date of issue to the date of redemption in order to build up a Fund represented by readily realisable securities, otherwise the requisite cash may not be forthcoming on the redemption date without seriously depleting the working capital.

LEASE ACCOUNT.

Purchased January 1, 1950. Term: Five Years. Renewable on Same Terms at end of Period.

Dr.		£	s.	d.			£	s.	d. Cr.
1950.					1954.				
Jan. 1	To Cash . . .	1,000	0	0	Dec. 31	By Sinking Fund Account . .	1,000	0	0
1955.									
Jan. 1	To Cash . . .	£1,000	0	0					

SINKING FUND ACCOUNT.

INVESTED IN GILT-EDGED SECURITIES PRODUCING 5% PER ANNUM.

Dr.		£	s.	d.			£	s.	d. Cr.
1954.					1950.				
Dec. 31	To Lease Account .	1,000	0	0	Dec. 31	By Profit and Loss Account . .	180	19	6
					1951.				
					Dec. 31	By Cash, Interest .	9	1	0
					„ 31	„ Profit and Loss Account . .	180	19	6
					1952.				
					Dec. 31	By Cash, Interest .	18	11	0
					„ 31	„ Profit and Loss Account . .	180	19	6
					1953.				
					Dec. 31	By Cash, Interest .	28	10	6
					„ 31	„ Profit and Loss Account . .	180	19	6
					1954.				
					Dec. 31	By Cash, Interest .	39	0	0
					„ 31	„ Profit and Loss Account . .	180	19	6
		£1,000	0	0			£1,000	0	0

SINKING FUND INVESTMENT ACCOUNT.

Dr.		£	s.	d.			£	s.	d. Cr.
1950.					1954.				
Dec. 31	To Cash, Instalment .	180	19	6	Dec. 31	By Cash . . .	1,000	0	0
1951.									
Dec. 31	To Cash, Interest re invested . .	9	1	0					
„ 31	„ Cash, Instalment .	180	19	6					
		371	0	0					
1952.									
Dec. 31	To Cash, Interest .	18	11	0					
„ 31	„ Cash, Instalment .	180	19	6					
		570	10	6					
1953.									
Dec. 31	To Cash, Interest .	28	10	6					
„ 31	„ Cash, Instalment .	180	19	6					
		780	0	6					
1954.									
Dec. 31	To Cash, Interest .	39	0	0					
„ 31	„ Cash, Instalment . .	180	19	6					
		£1,000	0	0			£1,000	0	0

Deficiency or Surplus on Realisation.—If the sinking fund has been invested in Stock Exchange securities, it is almost certain that the actual sum required will not be realised by their sale. Should there be a deficiency, this must be charged against profit: it is really equivalent to increasing the current year's appropriation to the fund. If, however, there is a surplus several methods of treatment are possible: there is nothing to prevent the surplus being credited to Profit and Loss; alternatively, it may be credited to General Reserve or to the Sinking Fund itself. The last of these alternatives is the best if the money is being re-invested, the redemption date not having yet arrived, but it cannot be said that this is an invariable rule.

(*d*) RESERVES AND PROVISIONS.

The distinction between these two terms is of great importance. Up to a few years ago the term "Reserve" was used rather indiscriminately, but its proper use has now been narrowed as explained below. A reserve may be either general or specific. If general, it is merely a book entry made for the purpose of taking part of the profit out of the Profit and Loss Account, and is an intimation, in effect, that the directors wish to retain the sum in question as part of the effective permanent capital employed in the business, and that consequently it is not to be paid out by way of dividend. However, the operation is reversible, and there is nothing *in law* to prevent any part of the general reserve being transferred back to the credit of profit and loss and paid out as dividend. Whether this is *commercially* reasonable or prudent must depend entirely on the facts of the case, and is for the directors to decide.

Secondly, a reserve may be specific in the sense that it is designed to meet a particular possible contingency, in which case it will be named appropriately, *e.g.* "Dividend Equalisation Reserve," "Reserve for Deferred Repairs." In order to be a true reserve there must be no element of actual liability present. The "Dividend Equalisation Reserve" is raised in case profits at some future date may possibly fall below the amount required to maintain dividends at their normal level, in particular to guard against the risk that in some future year there might not be sufficient profit to pay the dividend on the company's preference shares. In the case of the Deferred Repairs, these are repairs which for some reason (say war-time conditions) have not been carried out, but it is hoped to do so later on. There is here no actual liability to carry out these repairs: it is merely a matter of policy. If there has been default in carrying out repairs under the terms of a contract, then an actual liability arises in consequence of the default, and the amount set aside to meet the liability is not a reserve but a "provision."

The term "provision" in its general sense is a sum set aside either to meet a definite accruing liability (*e.g.* rent accrued) or to provide for a probability that certain current assets may not realise their book value (*e.g.* provision for doubtful debts). A provision, by its very nature, must be specific. It must here be pointed out, however, that the word "provision" is used in two somewhat different senses first, in the general sense as just described, and secondly, in a narrower sense defined by the Companies' Act, 1948 (Schedule VIII, Part IV), which states that (for the purposes of this schedule, which prescribed rules governing Accounts to be submitted to the members) the expression " provision " means any amount " written off or retained by way of providing for depreciation . . . in value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy." The important words here are " known liability " and " substantial accuracy." If the liability is not " known," it is clearly not a liability at all. Any amount set aside for an " unknown " liability is not a provision: it is a reserve. On the other hand, if the liability is " known " and can also be computed " with substantial accuracy " the amount is again not a " provision " for balance-sheet purposes: it is a liability and must be shown as such. It will be seen therefore that for balance-sheet purposes the word " provision " means something intermediate between " liability " on the one hand and " reserve " on the other: the term would be correctly used, for instance, to describe a sum set aside to meet possible damages in an action actually pending against the company, the issue of which is in doubt, or to meet possible taxation liability, the amount of which depended (to a substantial extent) on the settlement of a point of principle in dispute with the Inland Revenue.

It is important to understand the use of the word " provision " in this restricted sense. Nevertheless, for ordinary accountancy purposes the word is ordinarily used in its wider sense, and with reasonable care no confusion need arise.

Treatment in Accounts.—If the provisions are made in connection with assets, their amount is deducted from the relative asset in the Balance Sheet, *e.g.* Leaseholds, Exhaustion of Minerals, Machinery and Plant, and the like.

If the provisions relate to outstanding expenses such as wages, salaries, and the like, the amount provided is debited to the relative ledger account and brought down as a credit balance as shown on p. 27, and appears as a separate item after the caption " Sundry Creditors " in the Balance Sheet.

If the reserves are made for general purposes, they are set out separately under appropriate headings on the liabilities side of the Balance Sheet, *e.g.* Dividend Equalisation Fund, Employees' Pension Fund, General Reserve Fund, etc. This difference in treatment should be noted by the student.

Simple as it is, the correct treatment of such provisions and reserves appears to present difficulty to many examination candidates and marks are lost accordingly.

Illustration.—The following is extracted from an examination exercise :—

" When preparing the accounts (*i.e.* Manufacturing Account, Profit and Loss Account, and Balance Sheet) the subjoined information must be considered :—

(*a*) Three days' wages, £346; Office Salaries, £96; and Directors' Fees £500, had accrued due as on December 31, 19...

(*b*) Insurance (Factory), £82, had been paid in advance."

The following items appeared in the Trial Balance :—

"Manufacturing Wages, £13,862; Office Salaries, £1,345; Directors' Fees, £500; Insurance (Factory, £397; Office, £92), £489."

Solution.—When preparing the accounts the candidate should :—

(1) *Add* £346 to the Manufacturing Wages, £13,862, making the total debit to Manufacturing Account £14,208.

(2) *Add* £96 to Office Salaries, £1,345, making the total debit to Profit and Loss Account £1,441.

(3) *Add* £500 to Directors' Fees, £500, making the total debit to Profit and Loss Account £1,000.

(4) *Deduct* £82 from Factory Insurance, £397, reducing the total debit to Manufacturing Account to £315.

(5) On the *liabilities side* of the Balance Sheet, under the item "Sundry Creditors," he should *add* "Ditto, Outstanding Expenses, £942." The details composing this amount may be set out, if desired, but, in practice, the total only would be given. On the *assets side* of the Balance Sheet there should appear an item "Unexpired Insurance, £82," or some similar heading covering any expenses paid in advance.

Contingencies.—Contingent liabilities may exist which do not call for financial record in the books, but to the existence of which attention should be called by means of a note or notes on the face of the Balance Sheet. Such contingent liabilities are, *e.g.* arrears of cumulative preference dividends, liability on partly paid shares, or bills under discount, etc. These are not actual liabilities until they crystallise as such, and can only be noted for the information of shareholders. If, however, it is thought likely that a contingent liability may ultimately crystallise as an actual liability, it will obviously be prudent to make suitable provision for it in the body of the accounts. This is a case where the term "provision" in its narrower sense will apply.

Legal Position.—Limited companies, unless expressly directed by their Articles so to do, are under no obligation to create reserves. The Articles of most companies, however, follow the example set by Table A (Art. 117, Act of 1948), and give the directors power to make such reserves as they deem advisable prior to the distribution of profits.

In a private firm the question of reserves is, of course, decided at the discretion of the partners.

Local authorities carrying on trading undertakings are under obligation to provide reserve funds, the amount of which is frequently prescribed and restricted by the Statute, Order, or Licence under which they work. In some cases it is obligatory to invest reserves in outside securities, *e.g.* under the Provisional Orders for the electricity undertakings of local authorities. No such obligations exist in connection with non-trading sections of local administration.

Reserve Fund or Account.—Examination candidates are apt to lay down a hard-and-fast rule that reserves must of necessity be invested outside the business, and further, that the term "Fund" is employed only when the reserve is separately invested, the term "Account" being used to signify that the reserve is retained in the business, and not separately invested. The volume of academic discussion that has taken place in this connection is not very enlightening from the student's point of view. It might be convenient if the commercial community agreed to use such nomenclature, but no such agreement exists. Reference to published accounts will show that the two terms are used indiscriminately.

It is clear that a sinking fund raised for a specific purpose *must*, if it is to fulfil its proper function, be invested in outside securities. In commercial companies where profits are withheld from distribution and carried to reserve to enlarge the working capital and fortify the financial stability of the company, the question whether the amounts so withheld should be separately invested is one of financial policy to be determined in the light of all the circumstances. The possession of outside investments obviously strengthens the position of a company, if *it can afford them*. It cannot, however, indulge in luxuries of this kind if their purchase would seriously deplete the company's working capital, or if, by retaining the money in the business, it can be employed to far greater profit. In the case of banks, trust and financial companies, and in businesses where profits are liable to violent fluctuations, the outside investment of reserves in readily convertible securities may be conceded as being commendable and prudent.

Repairs and Renewals Fund.—Reserves created for these purposes are sometimes useful, particularly in trades subject to heavy repairs at irregular intervals. In such cases the Profit and Loss Account is charged with equal annual instalments, and the actual repairs, as and when effected, are debited against the reserve, the charge being thus equalised as between one trading period and another. The amount of the annual charge to Profit and Loss must be based on the experience of a series of past years, and this experience must be reviewed and corrected from time to time, care being taken that the reserve account, in normal circumstances, remains in credit.

Provision for Bad Debts.—Almost every examination Trial Balance includes a credit item of this kind, *e.g.* "Provision for Bad Debts, Dec. 31, 19..., £250." An extraordinary number of candidates come to grief when dealing with such an item, yet the treatment is so simple that it should not be necessary to refer to it in an advanced treatise.

The usual commercial practice is to provide a fixed amount on the Sundry Debtors at the close of the balancing period. The Journal entry, if one is made, is as follows:—

JOURNAL.

				Dr.			Cr.		
				£	s.	d.	£	s.	d.
19.. Dec. 31	Profit and Loss Account	Dr.	P.L.	250	0	0			
	To Provision for Bad and Doubtful Debts . .		P.L.				250	0	0
	Being 5% Provision upon the amount of the Sundry Debtors on this date (£5,000).								

In practice, the entry would probably take the form of a direct transfer from Profit and Loss Account to Provision for Bad Debts Account. It will be clear, therefore, that when the books are closed a credit balance of £250 remains on the Provision Account. This, let us assume, is the item that appears in the examination Trial Balance referred to above. It represents the provision made twelve months ago. Let us assume, further, in the Trial Balance, an item "Sundry Debtors, £7,000," and that the instructions state that "a provision for bad debts is to be made equal to 5% on the Sundry Debtors." For this purpose, therefore, £350 is required, but, as a provision of £250 already exists, the further charge against current profits will be no more than £100. The statement in the Profit and Loss Account will be as follows:—

	£	s.	d.	£	s.	d.
Provision for Bad Debts:—						
December 31, 19....	350	0	0			
Less *December* 31, 19...	250	0	0			
				100	0	0

and in the balance sheet as follows:—

	£	s.	d.	£	s.	d.
Sundry Debtors	7,000	0	0			
Less *Provision*	350	0	0			
				6,650	0	0

The Trial Balance may also include an item "Bad Debts," indicating that bad debts to the amount stated have actually occurred, and been written off during the year. It would not be incorrect to debit the amount of these debts against the provision of £250, and increase the new provision charge correspondingly. But it is the wiser course, and the usual commercial practice, to state the provision as set out above, and to debit the actual bad debts in a separate item to Profit and Loss Account.

If the amount owing by Sundry Debtors is less than in the preceding year, and the same rate of provision is made, an entry similar to that given above must be made on the *credit* side of the Profit and Loss Account, writing back that proportion of the provision that is no longer required.

A strange but common error made by examination candidates is to charge Profit and Loss Account with provision for bad debts at the rate given, but to ignore the already existing provision. The candidate either fails to "balance," or he deducts both the old and the new provisions from the Sundry Debtors.

It is the practice in some cases to take out a policy of insurance against losses arising from bad debts with "Lloyd's," or one of the Insurance Companies undertaking this class of risk. In such event the amount of the annual premium should be charged to Profit and Loss Account, no further provision being necessary.

Accumulated Depreciation.—The term "reserve" is not properly applicable here, but as it has sometimes been the custom in the past to provide for depreciation by building up in the books a "depreciation reserve," the subject is dealt with here. As already explained, the normal method of recording depreciation hitherto has been to credit the agreed amount to the asset account in question, bringing down the balance which represents the reduced value of the asset. In theory this is undoubtedly the correct practice, but, as regards limited companies at least, the writer is now inclined to advocate a different method, on the ground of expediency and convenience of record. Since the Companies Act, 1948, requires all fixed assets to be shown (where practicable) at cost, it is clear that it will assist the compilation of the balance sheet materially if all such assets in future are left standing in the books at cost. This involves the crediting of depreciation to a separate account, which will show the accumulating total of such depreciation; this is a further advantage, since it is a statutory obligation also to disclose such accumulated total. If the books are kept in the manner now advocated the details required for the Balance Sheet are easily extracted: this avoids the necessity which will otherwise arise to keep independent records or schedules outside the books in order to arrive at the statutory particulars. In view of what has already been said, the use of the term "Depreciation Reserve" or the like as a heading to the account in which the depreciation is recorded is deprecated as being misleading. The heading "Accumulated Depreciation" is suggested as an alternative.

The method has been explained and illustrated on pages 47 to 53. It goes almost without saying that it will be highly advisable to keep, outside the books, detailed inventories of the cost of each type of fixed asset, the totals of such inventories being reconciled annually with the corresponding asset accounts. If this is not done considerable difficulties will be liable to arise on the sale of an asset, and if it is done the annual reconciliation is a good check on the accuracy of the records.

In any case where original records of cost were not available in 1948 and such assets are shown in subsequent balance sheets at "net book value" (as on July 1, 1948), the amount of "net book value" can stand permanently (subject, of course, to subsequent sales) in the books in the same way.

Provision for Discounts.—It has already been stated that it is unusual to provide for discount on book debts, except in trades which allow exceptionally large discounts. Usually, discount (which may or may not be claimed) is treated as a financial transaction within the period when it is actually allowed. But occasionally the examination candidate is instructed to provide for discounts on the basis of a stated percentage on the book debts. In that case the procedure to be followed is identical with that already described in connection with bad debt provisions. In the still rarer event of an instruction being given to provide for discount that may be secured from Sundry Creditors, the discount claimable must be credited to Discount Account and debited to Discount Receivable Account, the balance of Discount Account being written off to Profit and Loss Account.

Dividend Equalisation Reserve (Fund).—Companies whose profits are liable from any cause to fluctuations sometimes create a reserve for the purpose of maintaining a level rate of dividend, drafts for this purpose being made on the reserve in years of lean profits. Such reserves are created in the usual way by appropriations from the profits of good years.

The term "Capital Reserve" now (since July 1, 1948) has a statutory meaning. Schedule VIII, Part IV, states that such a reserve " shall not include any amount regarded as free for distribution through the Profit and Loss Account," while (on the other hand) " a revenue reserve shall mean any reserve other than a capital reserve." It seems that there are two types of reserve coming within the meaning of the term " capital reserve " as here defined, viz. (*a*) reserves of which the Act forbids the distribution under any circumstances (Share Premium Account is an obvious example), and (*b*) reserves which the directors do not, for the time being at any rate, regard as free for distribution, but which might, under certain circumstances, become distributable at a later date. An example for this type would be the profit realised on the sale of a fixed asset. The subject does not, however, seem to be entirely free from doubt, and it is perhaps prudent to let the matter rest there for the time being.

In any event, the total of the Capital Reserves must be stated in the Balance Sheet.

It should be noted that the Capital Redemption Reserve Fund created when Redeemable Preference Shares are redeemed out of profits is an entirely distinct " capital reserve " which cannot be disturbed except as provided in S. 58 (see p. 304).

Reserve Liability.—This term is applied by limited companies to that portion of their subscribed capital that can be called up only in the event of liquidation. Under S. 60 of the Companies Act, 1948, a company may, by special resolution, take power to determine that a specified portion of each share shall remain uncalled, except in the event of liquidation. Banking companies, for example, frequently maintain considerable reserve liability on their shares for the protection of their customers.

Secret Reserves.—In the past, it has been the practice of banks, financial houses, and (less commonly) commercial firms, to accumulate reserves out of profits and not to disclose them in the accounts. This can be done by either: (*a*) charging capital expenditure direct to revenue, (*b*) providing excessive depreciation or even writing off fixed assets completely, either of which amount to very much the same thing as (*a*), (*c*) overstating liabilities, or (*d*) undervaluing current assets.

The ethics of the practice of creating such reserves have been long and hotly debated in the past. Whatever its advocates may say, there can be no doubt that the creation of such reserves can lend itself, in unscrupulous or even in careless hands, to serious abuses, and has in fact done so in the past. As regards commercial businesses, at any rate, the dispute has now become somewhat academic, since the provisions of the Act of 1948 practically prohibit the creation of such reserves. The general effect of Schedule VIII, coupled with the new form of report by the company's auditors, is to ensure that (so far as is reasonably possible) the company's position must be fairly stated in the Balance Sheet: clearly, if secret reserves do in fact exist this is not the case. The Act, however, places banks, discount companies, and assurance companies in a rather different position. It has so long been the accepted practice for institutions of this type to conceal their true financial strength by understating it in their published accounts, that their right to continue to do so (while undoubtedly reprehensible from an accountancy point of view) is tacitly admitted by Part III of Schedule VIII. Accordingly, a bank which likes to take advantage of these provisions will not disclose the cost of its fixed assets, and may (for instance) show a single inclusive figure for current liabilities and "inner reserves" (or like expression).

Past Losses.—The examination candidate is prone to declare with emphasis that past losses brought forward must be made good out of current profits before the distribution of dividends is possible. As a business policy, this is no doubt wise, but it cannot be said that companies are always legally obliged to make good past losses before declaring dividends. It would appear that continuity cannot be claimed for the Profit and Loss Account, and the Courts have refused to lay down a rule that the profits of a current year may not be distributed if a debit balance from previous years remains to be dealt with (*Ammonia Soda Co.* v. *Chamberlain*, [1918]; *Stapley* v. *Read*, [1924]).

IV. Appropriation Account.

Some examination candidates treat the Appropriation Account as a distinct account under a separate heading, whereas it is merely the final section of the Profit and Loss Account. Some companies refer to this statement as the *Net Profit Account*, or the *Net Revenue Account*.

An Appropriation Section is particularly necessary in the case of limited companies, but it is also applicable and valuable in partnership accounts. By carrying down the balance of net profit for the year to an Appropriation Section, the Profit and Loss Account is freed from the details showing the manner in which that profit is appropriated, permitting the Profit and Loss Account to give a clear view of the gross revenue earned for the year, the expenses incurred in earning that revenue, the net amount of the revenue earned, and facilitating comparisons with previous years.

When preparing solutions to examination questions, some candidates lose marks because they debit the Profit and Loss Account with all dividends paid, transfers to reserve, manager's commission on net profits, and the like, and credit the account with the balance brought forward from last year. This procedure does not, of course, affect the net balance available for distribution, but it reveals want of knowledge of modern practice, and it defeats the object of the Profit and Loss Account, which is to show at a glance the result of the current year's working.

Again, some candidates prepare an appropriation section but mar its effectiveness by debiting it with such items as depreciation, debenture interest, and the like, which are *charges against* the profit for the year, and not *appropriations of profit* available for distribution.

Illustration.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED JUNE 30, 19...

(APPROPRIATION SECTION.)

Dr.		£	s.	d.		Cr.	£	s.	d.
19... June 30	To Transfer to Reserve Account . .	2,500	0	0	19... June 30	By Balance brought down, being net profit for the year	18,756	0	0
„ 30	„ Dividend for Half-year to Dec. 31, 19..., on 6% Preference Shares .	2,500	0	0	„ 30	„ Balance brought forward from last account . .	5,538	0	0
„ 30	„ Interim Dividend at 10% on Ordinary Shares paid Dec. 21, 19.. . .	6,200	0	0					
„ 30	„ Preliminary Expenses written off.	962	0	0					
„ 30	„ Balance carried down . .	12,162	0	0					
		£24,324	0	0			£24,324	0	0
					19... June 30	By Balance brought down . .	12,162	0	0

In practice, the entries recording the appropriations made in the above account would be made *direct* from the Profit and Loss Account. If journalised, the entries would be as follows:—

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
19... une 30	Profit and Loss Account (Appropriation Section) Dr.	3,462	0	0			
	To Reserve Account				2,500	0	0
	„ Preliminary Expenses Account . . .				962	0	0
	Being amount transferred to Reserve and amount written off Preliminary Expenses as per resolution of Directors.						
„ 30	Profit and Loss Account (Appropriation Section) Dr.	8,700	0	0			
	To Interim Dividend (Ordinary Shares) . .				6,200	0	0
	„ Dividend on 6% Preference Shares . .				2,500	0	0
	Being transfer of dividends paid on the above shares during the year ended June 30, 19...						

The Directors' Report must contain a statement showing how the Board proposes to deal with the balance of profit shown by the Appropriation Account as being available for distribution (see pp. 365–367).

EXAMINATION QUESTIONS.

1. Indicate the difference between: (1) Receipts and Payments Account; 2) Income and Expenditure Account; (3) Revenue Account; (4) Profit and Loss Account.

2. Briefly state the considerations which would guide you in allocating xpenditure as between Capital and Revenue. (*Royal Society Arts.*)

3. "The nice adjustment of Expenditure between Capital and Revenue is often a difficult task."

In illustration of the above statement, describe two imaginery items of Expenditure incurred by a limited company which need so adjusting.

Give the entries you would make and your reasons for the treatment you adopt. (*Royal Society Arts.*)

4. Explain the principles you would adopt when allocating the undermentioned expenditure as between Capital and Revenue: (*a*) Stock (valued at £23,000) destroyed by fire, for which £24,860 was received from the Insurance Company. (*b*) Installation of electric power in a factory in place of steam. (*c*) Structural alterations to freehold factory. (*d*) Amortisation of lease. (*e*) Loss on sale of machinery. (*Chartered Accountants.*)

5. Set out shortly the several matters calling for special attention before the closing of the books at a balancing period. (*Chartered Secretaries.*)

6. How should "Goods in Transit" be treated for Balance Sheet purposes?

7. In some trades, goods are delivered accompanied by invoices dated two or three months ahead.

Does this practice call for any special treatment from an auditor's point of view? If so, describe the procedure you would adopt. (*Chartered Accountants.*)

8. Select *one only* of the undermentioned cases and state how stock should be taken, and the evidence you would require as to its existence and the value placed upon it: (*a*) Tobacco importer with goods in bond. (*b*) An export merchant with unsold consignments outstanding abroad. (*c*) A contractor with several uncompleted contracts in progress. (*Royal Society Arts.*)

9. The following items appear in the Balance Sheet of a limited company: (*a*) Stock of Goods, Produce and Debts in Africa, and Goods in Warehouse in Liverpool and elsewhere, £2,239,636 9*s.* 2*d.*; (*b*) Shipments in Transit Outward, £96,052 14*s.* 7*d.*; (*c*) Produce in Transit Homeward and in Store in Liverpool and elsewhere, £209,224 14*s.* 6*d.*; (*d*) Investments in, and Accounts Current with, Allied and Subsidiary Companies, £7,640,003 16*s.* 7*d.*; (*e*) Miscellaneous Investments, £110,855 6*s.* 8*d.*

In auditing the books of the company, how would you verify the correctness of these figures? (*Incorporated Accountants.*)

10. Would you defend, and if so, on what grounds, the non-presentation by a manufacturing company of its Trading and Profit and Loss Accounts at its annual meeting? (*Chartered Accountants.*)

11. Is the Profit and Loss Account, as set out below, properly drawn up? If not, submit the account as you would present it.

PROFIT AND LOSS ACCOUNT, DECEMBER 31.

Dr.	£	Cr.	£	£
To Salaries	820	By Stock	18,200	
,, Depreciation	1,401	,, *Less* January 1	17,400	800
,, Purchases	42,600			
,, Returns	362	,, Interest on investments	3,400	
,, Discounts	421	,, *Less* Loss on Sale of Investments	900	2,500
,, Dividend paid	3,842			
,, Directors' Fees	1,000	,, Balance from last year's account		4,321
,, Trade Expenses	1,200	,, Sales		59,940
,, Dividend (5% for year)	6,200	,, Error in Books		120
,, Manufacturing Wages	3,280	,, Unclaimed Dividends		321
,, Transfer to Reserve Account	4,000			
,, Balance carried to Balance Sheet	2,876			
	£68,002			£68,002

(*Royal Society Arts.*)

12. The following is the Trial Balance of a company on December 31 :—

	Dr.	Cr.
Stock, January 1	2,000	
Book Debts	2,000	
Plant and Machinery	1,000	
Wages	500	
Salaries	200	
Preference Shares		2,500
Ordinary Shares		2,500
Freeholds	3,000	
Creditors		1,000
General Reserve		1,000
Travelling Expenses	250	
Purchases	10,000	
Sales		15,000
Cash	3,050	
	£22,000	£22,000

Stock on December 31 was £2,500.

It is resolved : To write 10% off Plant and Machinery ; to provide on Bad and Doubtful Debts Account 10% of Book Debts ; to place £100 to a Bonus Fund for the Staff ; to place £1,250 to General Reserve ; to pay 5% on the Preference Shares, *less* tax ; to pay 6% on the Ordinary Shares, free of tax ; and to carry the balance forward.

Prepare the Trading and Profit and Loss Account for the year, and the Balance Sheet as at its close, after appropriating the profits as directed.

13. The Alpha Manufacturing Co., Ltd., had a nominal capital of £20,000, divided into 12,000 " A " shares and 8,000 " B " shares of £1 each of which 10,000 " A " and 5,000 " B " shares were issued and fully paid up

The Company's articles provided that the profits should be divided as follows, so far as the general meeting might decide : (1) In payment of a cumulative dividend of 10% on the " A " and 20% on the " B " shares. (2) In payment of a non-cumulative dividend of 15% on the " B " shares. (3) In payment of a non-cumulative dividend of 7½% on the " A " shares. (4) In payment of a further dividend *pro rata*, but so that the dividend on each " B " share should be twice that on each " A " share.

The general manager was entitled to a bonus of £10 for each 1% dividend paid on the " A " shares above 10%.

The profits for the year 19... amounted to £9,000, and there was an undistributed balance from 19... of £3,500.

The general meeting decided to pay the dividends under (1), (2), and (3) above, and a further dividend under (4) of 7½% on the " A " and 15% on the " B " shares ; and, after providing for the general manager's bonus, to place one-half of the balance to Reserve Fund, and carry the other half forward to next year.

Make out the Appropriation Account. (*Chartered Accountants.*)

14. Prepare from the following figures a Balance Sheet, Trading Account and Profit and Loss Account as at December 31, 19... :—

Factory Buildings (Cost), £30,000 ; Leasehold Properties, £24,000 ; Wages (Factory), £72,800 ; Salaries (Office), £7,900 ; Ground Rents purchased, £6,700 ; Advertising Expenses, £17,000 ; Sundry Creditors, £26,606 ; Sundry Debtors. £34,000 ; Bills Receivable, £23,200 ; Law Charges, £300 ; Repairs and Replacements (Factory), £1,700 ; Loose Tools, £2,800 ; Travelling Expenses, £4,102 ; Capital Account : 100,000 £1 shares issued Ordinary, fully paid ; 50,000 £1 shares issued Preference, 10*s*. paid ; Sales, £404,000 ; Purchases, £202,000 ; Furniture and Fixtures (Office), £3,010 ; Stock at January 1, 19..., £38,000 ; Freight and Insurance, £1,900 ; Bank Charges, £73 ; Cash at Bank, £3,000 ; Profit and Loss Account, Credit Balance, January 1, 19..., £23,000 ; Goodwill, £30,000 ; Returns (Sales Account), £4,002 ; Discounts (Dr.), £1,990 ; Discounts (Cr.), £3,080 ; Plant and Machinery, £27,000 ; Investments, £46,209.

The Stock at the end of the period was valued at £35,000.

In the preparation of the accounts allow for Depreciation as follows: 50% of the Tools Account, 5% of the Furniture, 10% of the Plant.

Create also a Reserve of 7½% on the value of the Leaseholds and 20% on the value of the Investments.

Provide also for a further £10,000 due on Advertising Account. (*Chartered Secretaries.*)

15. A company purchased a business as a going concern on January 1, 19..., with the right to the profits from October 1 previous. The Capital is: 5% Preference Shares, £50,000; 6% Preferred Ordinary Shares, £50,000; Deferred Ordinary Shares, £24,800. The year's profits to September 30 following the date of purchase are found to be £7,664. What appropriation of such profits should you make? (*Chartered Accountants.*)

16. Criticism is sometimes made that audited Balance Sheets and Accounts do not show clearly the appropriation of the balances at the credit of Profit and Loss Accounts. Give an instance (dealing with the figures of any account with which you may be familiar) of the manner in which in your opinion they should be presented to shareholders. (*Incorporated Accountants.*)

17. Give a short description of each of the following methods of providing for depreciation: Fixed-instalment System; Reducing-instalment System; Depreciation-fund System; Insurance-policy System.

Which, if any, of the foregoing systems of providing for depreciation would you recommend should be adopted in the case of a stud of horses?

18. Describe and contrast: (1) A Reserve which is a charge against profits; and (2) a Reserve which is an appropriation from profits.

Give an illustration of a reserve of each class, and state how they should appear in the accounts of a limited company, and describe an auditor's duty in relation thereto. (*Chartered Accountants.*)

19. What do you understand by an Appropriation Account? Should any of the following items appear in such an account: Salary of Manager; Interest on Debentures; Managing Director's Remuneration; Dividend on Ordinary Shares; Transfer to Reserve Account? Illustrate your answer with a *pro-forma* Appropriation Account, inserting imaginary figures.

20. Give two examples demonstrating how capital reserves—as distinguished from reserves created out of revenue—may arise.

Illustrate your answer by giving the entries you would make in the books and published accounts in respect of the examples you select. (*Royal Society Arts.*)

21. Describe the expenditure which, in your opinion, may be legitimately debited to Preliminary Expenses Account by a newly registered limited company.

State how you would deal with this expenditure in the books and published accounts of the company. (*London Chamber Commerce.*)

22. PROFIT AND LOSS ACCOUNT, DECEMBER 31, 19...

	£		£
To Balance from 19...	3,682	By Balance from Trading Account	14,766
,, Depreciation	1,521	,, Increase in Stock	1,241
,, Manager's Commission on net Trading Profit	393	,, Undrawn Dividends	200
,, Loss on Sale of Investments, less Interest received	1,721	,, Transfer from Bad Debt Reserve	250
,, Sales Returns	940		
,, Directors' Fees	1,000		
,, Proposed 5% Dividend for year 19...	5,000		
,, Transfer to Reserve	1,000		
,, Balance carried down	1,200		
	£16,457		£16,457

If, in your opinion, the above Profit and Loss Account is not correctly drawn up, criticise and amend it. (*Royal Society Arts.*)

CHAPTER IV

RECEIPTS AND PAYMENTS ACCOUNTS. INCOME AND EXPENDITURE ACCOUNTS. REVENUE ACCOUNTS

THE student's early studies in book-keeping should have familiarised him with these accounts. But examination experience goes to show that many candidates fail to understand them in all their essentials, and confuse their distinctions. It appears, therefore, to be advisable to define briefly their characteristics.

I. RECEIPTS AND PAYMENTS ACCOUNTS.

This is the simplest form in which a treasurer or other official of a non-trading institution or club can render an account of his stewardship. The account should consist of a classified summary of the actual cash receipts and payments for a particular period, showing the balance of cash in hand at the beginning and end of the period. No account is taken of any outstanding income or liabilities; the figures are confined to cash received and paid during the period. Benevolent, athletic, sporting, and social institutions or clubs frequently adopt this form of accounting to members and subscribers, the account usually being accompanied by an appeal for further subscriptions or donations!

As this kind of account is a condensed summary of the Cash Book, the receipts should be set out on the debit side and the payments on the credit side, and the balance of the account be carried forward to the next financial period.

Illustration.—The treasurer of the Dingley Dell Cricket Club started the year with a balance in hand of £14 8s. At the close of the season he analysed his Cash Book and submitted the following account:—

The Treasurer in account with

The Dingley Dell Cricket Club for the year ended October 31, 19..

	£	s.	d.					£	s.	d.
To Balance brought forward from last year	14	8	0	By Wages: Groundsman, Umpires, and Professional Coaches				535	10	0
,, Subscriptions	590	2	0	,, Repairs to Pavilion				22	4	1
,, Donations	10	0	0	,, Purchases: Mower, Bats, and Cricket Sundries				51	5	7
,, Gate Money at Matches	75	4	1		£	s.	d.			
				,, Lunches and Teas	88	4	7			
				Less Receipts	71	2	4			
								17	2	3
				,, Travelling Expenses of Team to Matches away				19	4	9
				,, Secretary's Expenses: Postage, Stationery, etc.				3	9	4
				,, Balance carried down				38	15	1
	£689	14	1					£689	14	1
To Balance brought down	38	15	1							

The above account is correctly presented, and meets the need of the case, if we assume that the Cricket Ground and Pavilion are lent to the Club free of charge, and that no subscriptions or liabilities are outstanding.

But the student must realise that, in many instances, such an account does not reveal the *actual income* for the period it purports to cover. It includes the balance from the previous period, and may also include receipts and payments belonging to previous or succeeding years, *e.g.* subscriptions or rent in arrear or paid in advance. Furthermore, capital receipts and expenditure may be included, and outstanding liabilities and income be disregarded. Thus, in the above illustration, assume for the sake of argument that the Club had acquired the Pavilion for £60, and that a subscriber had paid £4 4s., representing £2 2s. subscription for the current year and £2 2s. outstanding for the previous year; yet the whole of the £4 4s. would be included in the item "Subscriptions, £590 2s.," and the capital expenditure of £60 would have appeared as a payment.

If the receipts and payments are numerous, a Tabular Cash Book will save the treasurer considerable trouble when preparing his account.

II. INCOME AND EXPENDITURE ACCOUNTS.

As pointed out above, a Receipts and Payments Account does not necessarily show the actual income for the period covered by the account. It is the object of an Income and Expenditure Account precisely to ascertain and show that actual income. In other words, the function of this account, as employed by non-trading concerns, is exactly the same as that of the Profit and Loss Account of a commercial undertaking. It should include the whole of the income and expenditure appertaining to the period covered, no matter whether it is actually received or paid, or not. Examination candidates not infrequently state that an Income and Expenditure Account should include all income and expenditure *due for payment* within the period. This is incorrect. The account should include all income and expenditure appertaining to the period *whether due for payment or not*. That being so, apportionment must be made of any accruing income applicable to the period, and also of any outstanding charges for the period not yet due for payment. It is clear that these accounts pre-suppose double-entry book-keeping and demand a correlative Balance Sheet.

A company to which the *Companies Act*, 1948, applies is obliged to lay before a General Meeting at least once in every calendar year an Income and Expenditure Account if it does not present a Profit and Loss Account.

The construction of an Income and Expenditure Account being in essence the same as that of a Profit and Loss Account, it follows that the income will appear on the credit, and the outgoings properly chargeable against the income on the debit, side of the account. And since all outstanding income and liabilities have been taken into account, it also follows that the account must be conjoined with a Balance Sheet disclosing the financial position at the end of the period.

The balance of the Income and Expenditure Account represents the surplus or deficiency for the period, and must be added to, or deducted from, the "Capital" or "Surplus" fund in the Balance Sheet.

The Income and Expenditure Account forms an integral part of the accounts in a system of double-entry book-keeping, just as a Profit and Loss Account does, whereas a Receipts and Payments Account is a cash statement forming no part of the book-keeping system.

Inspection of the published accounts of non-trading institutions, societies, and clubs reveals an astonishing variety of statements which are frequently as inaccurate and misleading in results as they are unhappy in nomenclature, ranging as that does from "Cash Account," "Receipts and Payments," "Receipts and Expenditure," "Income and Expenditure," "Income and Payments" to "Balance Sheet!" It may be well, therefore, to recapitulate briefly the essential differences between Receipts and Payments Accounts, and Income and Expenditure Accounts.

Receipts and Payments Account.	*Income and Expenditure Account.*
This is nothing more than a classified summary of the Cash Book for a stated period. It deals with all cash received and paid during the period, irrespective of the year to which it may relate. No attempt is made to arrive at the *income* for the period, and no distinction is made between Capital and Revenue receipts or payments. The resulting balance represents the unexpended cash in hand or at the bank. Where no property or assets (other than cash) is held, and no liabilities exist, such an account meets the needs of the case, and no Balance Sheet is necessary.	This account shows the *actual income* for the current period only, together with the expenditure chargeable against that income, whether such income or expenditure is due or has been discharged or not within the period. The resulting balance shows the extent to which the income exceeds or falls short of the expenditure for the period. Since the account deals with outstanding income and/or expenditure, it must be accompanied by its relative Balance Sheet.

Illustration.—The following particulars relate to The Muggleton Horticultural Society for the year ended December 31, 19..:—

At the beginning of the year.—Cash in Bank, £180; War Loan in hand, £100 (at cost), accrued interest thereon, £2 10s.; Tents, Staging, etc., as per valuation, £125; Subscriptions Outstanding, £24 (received during year); Tradesman's Bill for Prizes Outstanding, £9 (paid during year).

During the year.—Subscriptions and Donations Received, £324; Exhibitors' Entrance Fees, £89 10s.; Advertisements in Show Catalogue Received, £36; Admission Money to Show, £129 8s.; Cost of Prizes and Competitions, £142 4s. 6*d.*; Sale of Catalogues, £3 6s. 6*d.*; Cost of Band, £28; Printing and Stationery, £38; Rent paid for Extra Staging and Chairs, £10; Entertainment Tax, £8 4s.; Police and Labour, £10 19s. 6*d.*; Judges' Fees, £5 5s.; Cost of New Marquee purchased, £150; Entrance Fees, Sports, and Competitions £41; Chair Hire received, £2 6s.; Proceeds of Concert, £12 8s. 6*d.*; Cost of New Staging and Show Tables purchased, £36 10s.; Refreshments: Cost, £72 1s. 4*d.*; Sales, £84 9s.; Interest on War Loan (18 months), £7 10s.; Donations made to: Muggleton Cottage Hospital, £100; Loamshire County Hospital, £100; War Loan purchased (December 29), cost, £101.

At end of year.—Subscriptions Outstanding, £21; Exhibitors' Entrance Fees Outstanding, £10 10s.; Advertisements in Show Catalogue Outstanding, The Secretary circulated the following account to members and subscribers:—

Muggleton Horticultural Society.

BALANCE SHEET, 19...

	£	s.	d.		£	s.	d.
Balance from last year	189	0	0	Prizes and Competitions	142	4	6
Subscriptions and Donations	324	0	0	Cost of Band	28	0	0
Exhibitors' Fees (Show)	89	10	0	Printing and Stationery	38	0	0
Competition Fees (Sports)	41	0	0	Rent of Staging and Chairs	10	0	0
Proceeds of Concert	12	8	6	Entertainment Tax	8	4	0
Profit on Refreshments	12	7	8	Police and Labour	10	19	6
Interest (War Loan)	7	10	0	Judges' Fees	5	5	0
Receipts from Advertisements	36	0	0	Marquee Purchased	150	0	0
Admission Money	129	8	0	New Staging and Show Tables	36	10	0
Sale of Catalogues	3	6	6	Donations:—			
Chair Hire Received	2	6	0	Muggleton Cottage Hospital	100	0	0
				Loamshire County Hospital	100	0	0
				War Loan Purchased	101	0	0
				Balance carried down	116	13	8
	£846	16	8		£846	16	8
Balance brought down	116	13	8				

It is needless to say that the above Statement is not a Balance Sheet. It is merely an analysis of the cash receipts and payments for the year. It does not show the financial result of the Society's Annual Show, neither does it disclose the financial position of the Society at the close of the year. As the Society possesses property and has outstanding assets and a liability, a Balance Sheet should be prepared. Furthermore, the chief object of the Society being to hold an annual show, the accounts should disclose the actual financial result of each show. Before proceeding further, the student is advised to prepare accounts from the figures given for comparison with those that follow.

In order to draw up a Balance Sheet, the financial position at the beginning of the year must be established. This appears to have been as follows:—

ASSETS.

	£	s.	d.
Cash at Bank	189	0	0
War Loan and Interest accrued	102	10	0
Tents, Staging, etc.	125	0	0
Debtors for Subscriptions	24	0	0
	440	10	0
Less Liability—			
Tradesman's Bill (Prizes)	9	0	0
Capital (or Surplus) Fund	£431	10	0

An Income and Expenditure Account and a Balance Sheet can now be pre pared as follows:—

Muggleton Horticultural Society.

INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	Cr.	£	s.	d.	£	s.	d.
To Prizes and Competitions	133	4	6	By Subscriptions and Donations				321	[illegible]	[illegible]
,, Cost of Band	25	0	0	,, Exhibitors' Fees Show				[illegible]	[illegible]	[illegible]
,, Printing and Stationery	41	2	6	,, Entrance Fees Sports				41	[illegible]	[illegible]
,, Rent of Staging and Chairs	10	0	0	,, Gate Money Show				[illegible]	[illegible]	[illegible]
,, Entertainment Tax	5	4	0	,, Advertisements in Catalogue				44	[illegible]	[illegible]
,, Police and Labour	16	19	6	,, Sale of Catalogues				[illegible]	[illegible]	[illegible]
,, Judges' Fees	5	5	0	,, Chair Hire				[illegible]	[illegible]	[illegible]
,, Donations:—				,, Proceeds of Concert				[illegible]	[illegible]	[illegible]
Muggleton Cottage Hospital	100	0	0		£	s.	d.			
Loamshire County Hospital	100	0	0	,, Refreshment Sales	[illegible]	[illegible]	[illegible]			
,, Balance carried to Capital Fund	234	10	8	*Less* Purchases, etc.	[illegible]	[illegible]	[illegible]			
								[illegible]	[illegible]	[illegible]
				,, Interest on War Loan				[illegible]	[illegible]	[illegible]
	£671	6	2					£671	6	2

BALANCE SHEET, DECEMBER 31, 19....

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Capital Fund:—							Tents, Staging, etc.	125	0	0			
As on Dec. 31, 19...	431	10	0				Additions during the year	186	10	0			
Surplus from Income and Expenditure Account	234	10	8								311	10	0
				666	0	8	Sundry Debtors				39	19	6
Sundry Creditor				3	2	6	War Loan at Cost				201	0	0
							Cash at Bank				116	13	8
				£669	3	2					£669	3	2

EXAMINATION QUESTION.

The account set out below has been submitted to you for audit. If you do not approve of it, criticise and amend it.

Loamshire Entomological Society.

INCOME AND EXPENDITURE ACCOUNT, DECEMBER 31, 19...

Dr.	£	s.	d.	£	s.	d.	Cr.	£	s.	d.
To Entrance Fees (20 at £10 10s.)				210	0	0	By Salaries and Wages	675	0	0
,, Fees for Life Membership (5 at £52 10s.)				262	10	0	,, Secretary's Salary	350	0	0
,, Annual Subscriptions	1,564	0	0				,, Rent, Rates, etc.	1,264	10	6
,, Ditto, paid in advance	65	0	0				,, Printing and Postages	36	10	7
				1,629	0	0	,, Repairs to Premises	124	1	4
,, Interest on War Loan				77	10	0	,, Interest on Bank Loan	57	7	4
,, Sundry Receipts				62	8	6	,, Balance carried down	970	4	1
,, Balance from last year				1,236	13	4				
				£3,478	1	10		£3,478	1	10
To Balance brought down				970	4	1				

Treasurer's Notes.—The Subscriptions in arrear amount to £121. Sundry Tradesmen's bills, £42 4s. 6d., were outstanding on December 31, but have since been paid. The Secretary's salary, though sanctioned by resolution of the Committee, has not yet been paid. The War Loan (1929–47), £2,000, was purchased at 98½. The lease of the Club premises (16 years to run) cost £2,124. The balance of the Bank Loan now outstanding is £1,000, secured by mortgage on the leasehold premises. (*Chartered Accountants. Intermediate.*)

Solution.

(*a*) *Criticism.*—The account submitted is not an Income and Expenditure Account: it is merely an analysis of the cash receipts and payments for the year, except that the Secretary's salary (£350) has been included as a payment, whereas the Treasurer's note states that the amount is still outstanding. It appears, therefore, that the Cash in hand should be £1,320 4*s.* 1*d.*, and not £970 4*s.* 1*d.* as stated.

(*b*) *Amendment.*—As this Society possesses assets and is liable for outstanding debts, the accounts should be presented in the form of an Income and Expenditure Account showing the actual income of the year, and a Balance Sheet disclosing the financial position at the close of the year.

Preliminary to the preparation of these accounts, the position of affairs at the beginning of the year must be ascertained as follows:—

ASSETS.

	£	s.	d.
Cash at Bank	1,236	13	4
War Loan at 98½	1,970	0	0
Lease	2,124	0	0
	£5,330	13	4
Less Liability— Bank Loan	1,000	0	0
Capital (or Surplus) Fund	£4,330	13	4

Loamshire Entomological Society.

INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	Cr.	£	s.	d.
To Salaries and Wages	[illegible]	0	0	By Entrance Fees	210	0	0
„ Secretary's Salary	350	0	0	„ Fees for Life Membership	262	10	0
„ Rent, Rates, etc.	1,2[illegible]	[illegible]	[illegible]	„ Annual Subscriptions	1,685	0	0
„ Printing and Postages	3[illegible]	1[illegible]	–	„ Interest on War Loan	77	10	0
„ Repairs to Premises	124	1	4	„ Sundry Receipts	62	8	6
„ Interest on Bank Loan	57	–	4	„ Balance carried to Capital Fund, being excess of expenditure over income	252	13	9
„ Expenses [illegible]	42	4	[illegible]				
	£2,550	2	3		£2,550	2	3

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.	£	s.	d.		£	s.	d.
Capital Fund as on December 31, 19..	4,3[illegible]	[illegible]	4				Lease at Cost	2,124	0	0
Less Income and Expenditure Account	252	13	[illegible]				War Loan at Cost	1,070	0	0
				[illegible]	[illegible]	–	Sundry Debtors	121	0	0
Sundry Creditors				[illegible]	4	[illegible]	Cash at Bank	1,320	4	1
Bank Loan [illegible]				1,[illegible]	[illegible]	[illegible]				
				[illegible]	4	[illegible]		£5,535	4	1

NOTE.—No provision has been made for wastage of the Lease.

Hospital Income and Expenditure Accounts.—Specified forms of account, drafted by a well-known chartered accountant, must be adopted by hospitals desiring to participate in the "King Edward" and similar Hospital Funds.

III. Revenue Accounts.

The object of a Revenue Account is to ascertain the net profit, or ncome, for the financial period to which it relates, and it can be preared only from a set of books kept on double-entry principles.

The distinction between the terms "Income and Expenditure Account," "Profit and Loss Account," and "Revenue Account" is urely technical, and is sometimes urged to the point of pedantry. ince the construction of these accounts and the objects served by hem are practically identical, no further treatment need be accorded hem here.

EXAMINATION QUESTIONS.

1. Explain the difference (if any) between a Revenue Account, an Income nd Expenditure Account, and a Receipts and Payments Account. (*London hamber Commerce.*)

2. Frequently so-called Balance Sheets are exhibited, particularly by charitble societies, whereas really they are only Cash Accounts. What further is ecessary to make them complete Balance Sheets, showing the true financial osition? (*Chartered Accountants.*)

3. Why is a Receipts and Payments Account unsatisfactory as an indication f the result of carrying on a business for a period? (*Chartered Accountants.*)

4. A war charity fund received for the six months ended December 31, 19..., 14,676 9*s.* 7*d.*, and interest on investments, £180 10*s.*

The administrative expenditure amounted to £3,838 10*s.* 6*d.*, and included 1,699 5*s.* 10*d.*, the cost and expenses of making appeals for funds. The Expendiure on Relief amounted to £5,213 9*s.* 11*d.*, and on Loans to £781. The latter vere not regarded as recoverable, but it was deemed advisable to leave the accounts pen. At the commencement of the period there was £2,000 invested in 4½% Var Loan which cost £1,077 5*s.*, and this was unrealised at the date you are nstructed to prepare a Balance Sheet and Income and Expenditure Account January 1, 19...). The cash at the Bank at July 1, 19..., was £505, and at December 31, 19..., the various committees were authorised to spend up to the ollowing limits: A, £3,416 4*s.* 2*d.*; B, £2,800 3*s.* 10*d.*; C, £1,100 5*s.* 2*d.*

Add to the accounts you draft, a report expressing your opinion on the situaion as disclosed by them. (*Incorporated Accountants.*)

5. The following Statement of Accounts of the Blankshire Benevolent Charity vas submitted as shown for adoption at the annual meeting. You are invited o criticise it.

STATEMENT OF ACCOUNTS FOR THE YEAR ENDED JUNE 30, 19...

Receipts.	£	s.	d.	Expenditure.	£	s.	d.
To Balance	457	6	5	By Annuities	805	0	0
.. Interest on Investments	270	15	4	.. Salary—			
.. Donations	383	12	0	Secretary	25	0	0
.. Special Appeal	182	14	0	Treasurer	25	0	0
.. Income Tax returned	24	13	8	.. Incidentals	6	15	3
.. Stamps overcharged	3	0	0	.. Printing	8	3	6
.. Bank Interest	8	12	0	.. Chief Rent	5	0	4
.. Amount Banked in error	1	1	6	.. Law Charges	6	5	0
				.. Bank Commission	2	8	9
				.. Sundries	8	12	2
				.. Balance in Bank	442	5	5
	£1,332	5	5		£1,332	5	5

Present Funds.

	Cost.		
	£	s.	d.
2½% Midland Railway Debenture Stock	1,165	6	8
3% London and North-Western Railway Debenture Stock	1,255	15	4
4% Lancashire and Yorkshire Guaranteed Stock	923	16	9
3% Manchester Corporation Stock	514	1	10
3½% Blackpool Corporation Stock	500	0	0
3½% Stockport Corporation Stock	2,500	0	0
Mortgages at 4%	3,300	0	0
	£10,162	3	7

Audited and certified correct.
HERBERT TRUSTEM.

The Securities upon which the present Funds of the Institution are invested were produced to and examined by us, and we certify that they are in perfect order and in safe custody.
WILLIAM T. SUPPLETON, *Chairman.*
JAMES UNION, *Vice-Chairman.*

(Incorporated Accountants.)

6. From the following Receipts and Payments Account of a charitable institution, and the subjoined information, prepare General Income and Expenditure Account for the year ended December 31, 19... :—

RECEIPTS AND PAYMENTS ACCOUNT.

19...		£	£	19...		£	£
Jan. 31.	To Balance—			Dec. 31.	By Payments to Pensioners		1,265
	Cash on deposit	500		,,	,, Rent, three quarters		75
,,	Cash on current account	116		,,	,, Office Expenses and Salaries		275
,,	Cash in hand	7		,,	,, Collector's Commission		37
			623	,,	,, Printing Year Book, etc.		26
Dec. 31.	,, Donations and Subscriptions		1,272	,,	,, Postages		18
,,	,, Legacies		400	,,	,, Gratuities from Special Fund		143
,,	,, Special Fund Donations		170	,,	,, Investment in £500 Birmingham 3% Stock		300
,,	,, Interest on Investments		135	,,	,, Balance—	£	
,,	,, Interest on Deposit		24		Cash on deposit	400	
				,,	Cash on current account	73	
					Cash in hand	12	
				,,			485
			£2,624				£2,624

The committee of management resolve that one-half of legacies received shall be treated as income, the remainder being capital, and that the "Special Fund" should be separated from the "General Funds." Bring into account income tax recoverable. A quarter's rent was unpaid at December 31. Sundry persons owed £15 for advertisements in the Year Book. *(Chartered Accountants.)*

CHAPTER V

THE BALANCE SHEET

WHEN the figures necessary for the compilation of the Trading and Profit and Loss Accounts have been extracted from the Trial Balance, he remaining items should consist of the details necessary for the construction of the Balance Sheet. Items of a like nature must be grouped together, since the totals only of the generic groups can be dealt with in the Balance Sheet. In order that this may be done, it s customary to extract the balances from the various ledgers on separate lists, the totals only of the several lists being entered in the Trial Balance. Thus the Sales Ledgers' balances will furnish the otal " Sundry Debtors "; the Bought Ledgers' balances, the total ' Sundry Creditors "; the Investment Ledger balances, the total ' Investments," and so on. The strictest care must be taken that the grouping of the items is not misleading, as it will be if heterogeneous assets and liabilities are lumped together. The material thus accumulated and classified will furnish the framework of the Balance Sheet, but much more must be done before the document can be regarded as complete.

Basis of Balance Sheet.—The " Statement of Affairs " prepared in nsolvency proceedings is analogous to a Balance Sheet. But in a Statement of Affairs the assets are valued at their estimated break-up values in order that creditors may forecast the result of immediate realisation, whereas in a Balance Sheet the values of the assets are their values to the business as a going concern. The definition of a Balance Sheet, usually tendered by the student as " a statement of assets and liabilities," cannot be considered satisfactory in view of the fact that items may be included in it that do not belong to either category, *e.g.* premiums on the issue of shares, debit balance of Profit and Loss Account, preliminary expenses, reserves, etc. A better definition is that *a Balance Sheet is a classified summary of the ledger balances remaining after closing all revenue items into the Profit and Loss Account.*

As we have seen, the elimination from the Trial Balance of the Trading and Profit and Loss items leaves us with the framework of the Balance Sheet. But before that framework can be utilised other things must be done. The liabilities must be carefully scrutinised to ensure that all outstanding debts have been brought into account. Where available, the Stores Inward Book kept by the store-keeper should be checked to ensure that the invoices representing the latest deliveries of goods have been properly posted, and that goods represented by invoices entered immediately after the close of the year have not been included in the stock valuation. If no Stores Book is kept, the Carrier's Book, or Warehouseman's Rough Book, or similar records may serve the same purpose. Examination of the Bills Payable Book will ensure that all outstanding bills are properly recorded in the financial books. As regards limited companies, the Directors' Minute Book may afford evidence of contingent or other liabilities which need to be recorded. The assets, also, need careful scrutiny to ensure that the values placed upon them are justified, and that all due provision for known waste has been made.

Double Account System.—This is a method of presentation of published accounts, not a system of book-keeping. It was formerly a statutory obligation of certain types of public-utility undertakings, notably railways, canals, and electricity and gas undertakings, to present their accounts in this form. Since, however, all these undertakings have been nationalised the system has become of no more than historical interest.

Limited Companies and Balance Sheets.—The Companies Act, 1948, makes it compulsory for every company within the meaning of that Act to draw up and lay before the company in General Meeting not later than eighteen months after incorporation and, subsequently, once at least in every calender year a Profit and Loss Account (or, in the case of a company not trading for profit, an Income and Expenditure Account) and a Balance Sheet. The Profit and Loss Account (in the case of the first accounts) must be for the period since the incorporation of the company or (in any other case) for the period since the date of the last accounts, and in either case made up to a date not more than nine months before the date of the meeting or (in the case of a company having interests abroad) not more than twelve months. The Balance Sheet must be made up as on the date to which the Profit and Loss Account (or Income and Expenditure Account) is made up. (Under the 1929 Act only a Balance Sheet was necessary, but note that the 1948 Act requires a Profit and Loss Account in addition.) The Board of Trade may, in individual cases, and for special reasons, extend the above periods. The Act also provides for the Balance Sheet to be signed on behalf of the board of directors by at least two directors, or by the sole director. Provision is also made for audit.

A copy of the Balance Sheet and of all other documents required to be annexed thereto (*e.g.* Profit and Loss Account and auditors' certificate) must be sent, not less than twenty-one days before the date of the meeting, to every member of the company (whether or not he is entitled to receive notices of general meetings) and to every debenture holder (S. 158). The Balance Sheet must set out (at least) certain particulars, as laid down in the Eighth Schedule and elsewhere: these particulars are enumerated on pp. 83–85.

Responsibility for the Balance Sheet.—The accounts of private firms are of concern to the partners only. The responsibility for the Balance Sheet of a limited company rests upon the Directors of the Company. It is their Balance Sheet, in token whereof, as we have seen, the Act of 1948 requires that the signatures of two of their number shall be appended to it "on behalf of the Board" (S. 155). It is true that the auditors' certificate also appears at the foot of the Balance Sheet. But auditors cannot dictate its form, unless it fails to comply with the Act (see p. 288) or it is misleading or inaccurate, nor do they accept responsibility for the values placed upon the assets. Auditors do not certify these values; indeed, they cannot, since these values are frequently matters not of actual fact, but of opinion. The auditor's duty is to report on every Profit and Loss Account and Balance Sheet (and all group accounts) laid before the company in general meeting (S. 162), and the report must expressly state the following matters (set out in the Ninth Schedule to the Act): (1) whether they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit, (2) whether, in their opinion, proper books have been kept and proper returns received from any branches not visited by them, (3) whether the Balance Sheet and Profit and Loss Account are in agreement with the books of account and returns, and (4) whether to the best of their information these accounts give the information required by the Act in the manner so required and give a fair view, respectively, of the state of the company's affairs and the profit or loss for the financial period. In the case of group accounts there are further requirements with which we need not deal here.

Form of Balance Sheet.—The draftsman of the Balance Sheet of a private partnership must study the Articles of Partnership, which, almost certainly, will contain clauses affecting the accounts, *e.g.* in such matters as fixed capital, drawings, interest, loans, etc. As regards public companies, if the undertaking is amenable to any particular Act of Parliament, the statutory form prescribed by the particular controlling Act must, of course, be followed. Apart from parliamentary companies, there is no prescribed form of Balance Sheet. It is difficult to imagine a stereotyped form that would suit all and every type of commercial or financial undertaking. Unification is, in fact, impossible.*

A Balance Sheet is a condensed and classified list, taken out upon a sheet of paper, of the balances remaining open in a set of books after the Trading and Profit and Loss Accounts have been prepared and closed. It is not a ledger account, and balances cannot therefore be transferred to it. The item occasionally seen in some published Profit and Loss Accounts, " Balance transferred to Balance Sheet," is therefore unfortunate. The Profit and Loss Account is a ledger account, but the Balance Sheet is not.

In America, and on the Continent, and also to some extent in Scotland, the assets are placed on the left-hand side, and the liabilities on the right-hand side of the Balance Sheet. In England, the reverse order is followed, apparently to the great regret of some controversialists. But the student will be well advised not to be perturbed over this variation of practice, which is one more of tradition than of principle. In this country it is a frequent practice to term the left- and right-hand sides of the Balance Sheet, respectively, the "Liabilities" (or "Capital and Liabilities") and the "Assets" sides, and, although these captions are frequently not strictly accurate, the student is recommended cheerfully to accept the fact. Neither need he worry unduly because another school may tell him that "Debtor" and "Creditor" are more precise captions for the two sides of the Balance Sheet, for, after all, "Sundry Creditors" appear on the debtor (Dr.) side, and "Sundry Debtors" on the Creditor (Cr.) side! No reasonable examiner will complain at either description.

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* Article 81 of Table A in the First Schedule to the Companies Act of 1862 contained a form of Balance Sheet. But that effort at formulation was not very happy, and was not repeated in subsequent Acts.

It is an error common to many candidates to head the Balance Sheet, *e.g.*:—

The XYZ Co., Ltd. Balance Sheet for the year ended December 31, 19...

This is inaccurate. A Balance Sheet sets forth the financial position as on a definite date, and does not cover a period, as is the case with a Profit and Loss Account.

Marshalling Assets and Liabilities.—A reasonable and consistent method of marshalling assets and liabilities must be adopted, and the student will save time if he enters the examination room with an orderly method of so doing already fixed in his mind. Two methods are commonly employed:—

(*a*) Where the assets are ranged in the order of their permanence and unrealisability, and as far as possible the capital and relevant liabilities are ranged against them.

(*b*) Where the assets are placed in the order of their realisability, beginning with Cash in hand, and so on, and the liabilities are ranged in the order in which their payment can be demanded.

Method (*a*) is employed by the vast majority of commercial undertakings; method (*b*) is adopted by, and is suitable for, banks and kindred institutions. The examination candidate should obtain equal marks for either method, provided that he intelligently applies the method selected.

Information Afforded by Balance Sheet.—A sharp distinction must be drawn between Balance Sheets drawn up for presentation after June 30, 1948, which must comply with the Companies Act, 1948, and Balance Sheets drawn up before that date. The latter had to conform to the requirements of the 1929 Act, which were very much less detailed and stringent, and as that Act is now entirely superseded by the Act of 1948 no useful object would be served now by detailing its provisions. As regards balance sheets drawn up after June 1948, S. 149 lays down that "every balance sheet of a company shall give a true and fair view of the state of affairs . . ." and "shall comply with the requirements of the Eighth Schedule to this Act, so far as applicable thereto." This schedule is so comprehensive and detailed that it is necessary here to set out most of its provisions practically in full; omitting, however, a few which apply only in particular circumstances, and are accordingly of less general importance than the others. The paragraphs are numbered in accordance with the schedule, but the text does not necessarily follow the actual wording of the Act verbatim:—

(2) The authorised share capital, issued share capital, liabilities and assets shall be summarised, with such particulars as are necessary to disclose the general nature of the assets and liabilities:—

(*a*) requirements as to redeemable preference shares;
(*b*) capital on which interest has been paid out of capital;
(*c*) the amount of the share premium account must be specified.

(Particulars as to redeemed debentures which the company has power to reissue.)

(3) The following are to be separately stated, so far as not written off:—

(*a*) preliminary expenses;
(*b*) any expenses in connection with the issue of any shares or debentures;
(*c*) commissions paid in respect of any shares or debentures;
(*d*) discounts allowed in respect of debentures;
(*e*) discounts allowed on the issue of shares at a discount.

(4) (i) The reserves, provisions, liabilities, and fixed and current assets are to be classified under headings appropriate to the business.

(ii) Fixed assets must be distinguished from current assets.

(iii) The method used to arrive at the amount of each class of fixed assets must be stated.

(5) Except as provided below, the amount of any fixed asset is to be the difference between the cost (or valuation) and the aggregate depreciation written off since the date of purchase (or valuation). As regards fixed assets the cost of which cannot be ascertained without unreasonable expense or delay, there is to be substituted the net amount at which such assets were standing in the books "at the commencement of the Act" (5 (2) (*a*)), and such figure is to be treated as though it were a valuation made on that date. In practice the accounting date next before July 1, 1948, is usually taken, and it is recommended that the amount so shown should be described as the "net book value" of the assets in question as on that date. Suggested alternative methods of arrangement are shown on p. 96.

(5) (3) provides that as regards assets valued on the basis of cost (or "net book value") less depreciation there is to be shown (*a*) the aggregate cost (or "net book value") and (*b*) the aggregate depreciation.

The foregoing is not to apply to assets dealt with as mentioned in (5) (2) (*b*), (*c*), or (*d*) below.

(5) (2) (*b*) Assets the replacement of which is provided for by making provision for renewals (*i.e.* by raising a renewals fund, which would be shown on the other side of the Balance Sheet as a "provision") or by charging the cost of replacement direct to revenue. In either of these cases depreciation need not, and would not, be shown as a deduction from the cost of the asset.

(5) (4) provides that as regards assets dealt with in either of these

ways there shall be stated: (a) the manner in which their replacement is provided for, and (b) the aggregate amount of the provision (if any) made for renewals and not used.

(5) (2) (c) Investments of which the market value is stated, see (11) (8) below.

(5) (2) (d) Goodwill, patents, or trade marks (see (8) (1) (b) below).

(6) There are to be stated under separate headings the aggregate amounts respectively of capital reserves, revenue reserves, and provisions. For the definitions of these terms see pp. 85–86.

(7) Unless the information is given in the Profit and Loss Account or in a statement or report annexed thereto, there is to be shown the source of any increase in the amounts of the reserves or provisions or the application of any decrease in the same. If any of these figures in the Balance Sheet are divided under sub-headings this rule is to apply to each of the separate amounts shown under each sub-heading. (For instance, if two provisions were shown, one for taxation and the other for leasehold renewal, it would not be permissible to transfer a sum from one to the other without disclosing what had been done, notwithstanding that the total of the provisions would be unchanged by the transfer.)

(8) (1) (a) There are to be shown under separate headings the respective totals of the trade investments, quoted investments other than trade investments, and unquoted investments other than trade investments. The expression "trade investments" is not defined, and has given rise to some discussion: in the authors' opinion it means an investment made for "trade" reasons as opposed to financial reasons, e.g. an investment in a business with which the company has trading relations (but not so substantial an investment as to give a controlling interest in that business, in which case the business would be a "subsidiary" and quite different rules would apply).

(8) (1) (b) There must be shown separately the amount of any goodwill, patents, or trade marks so far as ascertainable and not written off. "Ascertainable" means not only ascertainable from the company's books but also ascertainable from any contract for the purchase or sale of any property by the company or from any conveyance or any documents relating to stamp duty on the same.

There are to be shown, under separate headings:—

(8) (1) (c) the aggregate amounts of any outstanding loans to employees for the purpose of enabling them to subscribe for shares in the company (authorised by S. 54).

(d) the aggregate amount of any bank loans or overdrafts, and

(e) the net aggregate amount (after deduction of income tax) which is recommended for distribution by way of dividend.

(8) (2) Goodwill, patents, and trade marks *may*, if desired, be shown as a single item.

(9) Where any liability of the company is secured "otherwise than by operation of law," the fact that the liability is so secured must be stated, but it is not necessary to state the assets on which the liability is secured. This would apply most commonly in the case of a bank

loan or debentures issued by the company: it is sufficient merely to add the word "secured" after the heading in question.

(10) Where any of the company's debentures are held by a nominee of or trustee for the company, the nominal amount of the debentures and the amount at which they are stated in the company's books is to be stated.

(11) This paragraph sets out a number of unrelated matters. If not otherwise shown, they are to be stated in a note, or in a statement or report annexed to the accounts. The matters are:—

(11) (2) The number, description, and amount of any shares of the company which any person has an option to subscribe for, giving: (*a*) the period during which the option is exercisable; (*b*) the price to be paid for shares subscribed for under it.

(11) (3) Particulars of the arrears of fixed cumulative dividends on the company's shares, giving periods and amounts, and distinguishing between different classes if there are more than one.

(11) (4) Particulars of any charge on the assets of the company to secure the liabilities of any other person.

(11) (5) The general nature of any other contingent liabilities not provided for, including, if possible, the aggregate estimated amount of those liabilities.

(11) (6) The aggregate estimated amount of contracts for capital expenditure, so far as not provided for.

(11) (7) If in the opinion of the directors any of the current assets have not a value, on realisation in the ordinary course of the company's business, at least equal to the amount at which they are stated, the fact that the directors are of that opinion.

(11) (8) The aggregate market value of the company's quoted investments, where this differs from the balance-sheet value.

(11) (9) The basis on which foreign currencies have been converted into sterling.

(11) (10) The basis on which the amount, if any, set aside for United Kingdom income tax is computed.

(11) (11) Except in the case of the first Balance Sheet laid before the company after July 1, 1948, the corresponding amounts at the end of the preceding financial year for all items shown in the Balance Sheet.

Some of the paragraphs enumerated contain a clause permitting the omission of the information in question required to be disclosed "if the amount involved is not material." There is, however, no attempt to define the word "material," and this must clearly remain in the reasonable discretion of the directors, subject of course to the auditors' opinion.

Definitions—"Provisions"—"Reserves."—These are given in Part IV of the Eighth Schedule, and since they are important are given verbatim:—

> The expression "*provision*" shall . . . mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any

known liability of which the amount cannot be determined with substantial accuracy.

The expression "*reserve*" shall not, subject as aforesaid, include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing for any known liability.

The expression "*capital reserve*" shall not include any amount regarded as free for distribution through the Profit and Loss Account and the expression "*revenue reserve*" shall mean any reserve other than a capital reserve.

Further, the expression "*liability*" (as used in the above definitions) is to include all liabilities in respect of expenditure contracted for and all disputed or contingent liabilities.

Part IV also provides that where either an amount written off or retained by way of providing for depreciation etc. of assets or any amount retained by way of providing for any known liability is in excess of that which in the opinion of the directors is reasonably necessary, the excess is to be treated as a reserve and not a provision.

The above definitions are of the utmost importance and require careful study in order that a Balance Sheet may be correctly compiled. It will be seen that the rule by which excessive depreciation is to be treated as a reserve expressly prohibits the practice of writing off excessive depreciation without disclosing the fact, thus barring the using of this (formerly very prevalent) method of creating a "secret reserve."

There is also a point worth noting with regard to capital reserves. The words "regarded as free for distribution" must presumably mean "free in the opinion of the directors" and do not discriminate between reserves the distribution of which are prohibited by law (*e.g.* share-premium account and capital redemption reserve fund) and those which, for one reason or another, the directors may not think to be properly distributable now but which might possibly become so at a later date. An instance of the latter class would be a capital profit realised on the sale of a fixed asset where the present market value of other fixed assets was less than their book value: it is considered that this profit, though a capital one, could become distributable later on if the remaining fixed assets in question were written down to below market value or realised and a net surplus remained after such sales were completed. Notwithstanding this possibility, it seems that the profit on the first sale, under the conditions envisaged, could properly be considered a capital reserve. If so, it would follow that there are really two distinct classes of capital reserve:—

(*a*) those which can *never* be distributed (unless on a capital reconstruction or liquidation of course), and (*b*) those which became distributable later in the light of subsequent happenings.

However, the authors would not like to be dogmatic on the point and there may be room for another opinion.

It may be useful at this point to consider briefly the subject of assets and liabilities in general, and also in detail some particular assets and liabilities that commonly find a place in Balance Sheets.

ASSETS.

Assets Generally.—Assets may be divided into three classes: (*a*) Fixed Assets; (*b*) Current Assets; (*c*) Assets of Unrealisable Value.

(*a*) *Fixed Assets.*—These are assets of a more or less permanent kind that are held not for sale, but solely in order to earn revenue. Of such are Land, Buildings, Machinery, etc.

(*b*) *Current Assets* are those which have been made or acquired for sale and conversion into cash. Stock, Book Debts, Temporary Investments, etc., illustrate this kind of assets.

(*c*) *Assets of Unrealisable Value.*—To this category belong such assets as Preliminary Expenses, Debenture Issue Expenses, the debit balance of Profit and Loss Account, and the like. Such assets as these should be segregated at the end of the Balance Sheet, and any deductions that have been written off them during the year should be clearly shown.

Some writers seem fond of labelling assets as "tangible" or "intangible." An illustration of this now lies before the author. He is instructed that book debts is an example of a tangible asset, and goodwill of an intangible asset. But he remembers that he has some outstanding book debts which he wishes were tangible, and recalls an instance of a sale of goodwill for half a million sterling, which, in that instance, certainly could not have been very intangible! The examination candidate is advised not to be too free in his use of these labels.

The Act does not strictly require the separation of loan debtors (except in certain specified cases) from trade debtors; nevertheless, it is good practice to make the separation unless at any rate the amount of the loans is trifling. This is one of the instances where there is much to be said for not confining oneself to the strict letter of the law: there are many others.

Any sums due from Directors or other officers of the company *must* be separately stated. S. 190 absolutely prohibits the making of loans to directors (formerly permissible, but the details had to be disclosed in the Balance Sheet) except in the case of an exempt private company (see p. 269).

As already stated, investments must be separated into three categories, viz.:—

(*a*) Trade Investments.
(*b*) Quoted investments other than trade investments.
(*c*) Unquoted investments other than trade investments.

We have already considered the meaning of "trade investments." As regards the second category, the market value must be stated (normally by way of a footnote) unless these investments are already shown at market value as, if they are dealt with as current assets, they might be.

Investments may, according to circumstances, be fixed assets, current assets, or not strictly either: it must depend on the circumstances of the case and for what purpose each investment is held. At one end of the scale, a trade investment is almost certain to be a fixed asset; at the other, an investment in a British Government stock, readily realisable and representing no more than a temporary use of surplus money, is beyond question a current asset. A particular type of investment, always shown *separately* under the heading of current assets and appearing in the majority of modern Balance Sheets is "Tax Reserve Certificates." It is arguable that this is perhaps more of the nature of a "payment in advance" than a true investment. However that may be, if these certificates are separately stated, as they should be, the point (from a Balance Sheet point of view), becomes academic.

Goodwill, patents, and trade marks *must* be separated from other assets if it is possible (by reference if necessary to sources of information outside the books of account) to do so. It is not obligatory to separate goodwill, on the one hand, from patents and trade marks on the other, but it is good practice to do so if the information is available: clearly, if, as often happens in practice, they have all been purchased together for an inclusive sum the separation is impossible.

Stock in hand must, of course, be stated separately, and it is usual to state the basis of valuation, *e.g.* "at market value," "at the lower of cost or market value," "as valued by the managing director," etc. Since the rules laid down in the Eighth Schedule refer only to fixed assets they do not apply to stock. It is unusual (as regards a public company at any rate) to show the subdivision of stock as between its component parts, *e.g.* raw materials, finished goods, packing materials, etc.

Valuation of Assets.—It has already been stated that the values of the fixed assets in a Balance Sheet should be based upon their values to a going concern. These values are by no means always the same as their sale or current market values. The going-concern values may be greater or less than the market values—the matter is of little moment. The fixed assets employed by a commercial undertaking are employed for profit-earning purposes, and the only practicable basis of valuation is cost less reasonable provision for waste and depreciation. Current, or "quick" assets as Americans call them, should, on the other hand, be valued as nearly as possible at their actual present value to a going concern, which, in some cases at any rate, is their market price if less than cost. It will be obvious that the going-concern basis of valuation adopted must be consistent year by year, otherwise the accuracy of the profits shown as having accrued since the previous Balance Sheet will be vitiated. The student will realise the supreme importance of the values placed upon the Assets in a Balance Sheet. If these values are not based upon reasonably accurate data, not only will the financial position of the undertaking be stated falsely, but also the profits shown will be misleading—so intimate is the relation between capital and revenue.

Bankers and others, inspecting a Balance Sheet upon a request for a loan, will naturally review the assets rather upon a break-up basis than on that of a going concern.

Land and Buildings.—It is impossible to adopt hard-and-fast rules when valuing these assets. Freehold buildings may be slowly wasting owing to wear and tear; or depreciating in value because of growing obsolescence, whereas the land on which they stand may be steadily appreciating in value. Freehold land will probably fluctuate in value, and the appreciation or depreciation may even be permanent. Unless there are cogent reasons against such a course, freehold land should be stated at cost; and the legal, surveyors', and other expenses of acquiring the land may legitimately be added to that cost, although it is more prudent, perhaps, to charge them to revenue over a term of years.

It cannot be affirmed that it is *ultra vires* to revalue an asset that has appreciated, and employ whatever increase in value may be thereby disclosed to decrease or eradicate an adverse balance standing at Profit and Loss Account. Directors who adopted this course were held to be justified in the absence of any fraudulent intent (*Ammonia Soda Co., Ltd.*, v. *Chamberlain and others*, [1918]). But, in the majority of cases, it is unwise to take credit for unrealised profits. Additions to freehold property may be capitalised at cost, provided always that the book value of any portion of the building demolished to permit of their erection is duly written off.

The cost of leasehold land, and the subsequent expenditure upon it, must be written off over the life of the lease. If there is an option for renewal, and it is desired to exercise the option, the best method, perhaps, of providing funds for the new lease is by means of an endowment policy of assurance.

Buildings stand in a different category from land. Freehold property, if kept in an efficient state of repair, need not be depreciated, but this cannot be laid down as an invariable rule. The original construction, present state, and other circumstances affecting the property must be taken into consideration.

Leasehold buildings must be treated as stated above in the matter of land. If the building is unlikely to last out the lease, that factor must also be taken into consideration.

From a mortgagee's or banker's point of view, the chief questions to be answered are: (1) Can the property be easily converted to other than its present use? (2) What is the site value? (3) Is the locality in which the building is situated waning or increasing in popularity?

Provision for wastage in connection with leases is most suitably made by the annuity method.

Frequently, a premium is paid for a lease. This premium represents commuted rent, and should be spread in equal instalments over the term of the lease. Money is frequently raised in these days of heavy death duties by the grant of leases at reduced rents in consideration of the payment of a cash premium. Such premiums represent rent paid in advance, and, similarly, should be spread over the term of the lease.

Dilapidations.—The liability to yield up demised premises in good repair at the end of a tenancy is usually attached to leasehold agreements. This is a contingent liability that must be provided for. The extent of the liability should be carefully estimated by professional advisers, and a fund should be raised and invested, preferably outside the business, in order to meet it. Assurance policies are sometimes taken out for this purpose.

Balance at Bank.—The most usual practice is to include in the Balance Sheet the balance as shown by the Cash Book. However, this should not be taken as an invariable rule, and there is a school of thought which considers that it is more correct to show the balance which appears in the bank pass book, on the ground that this is the actual amount standing to the company's credit (or debit) with the bank on the date in question. The authors are rather inclined to favour this view, but would not press it to the point of insisting that this method be adopted in a case where the more usual method had been adopted in the past and the directors disliked the idea of making a change.

Occasionally, the ordinary method is definitely wrong and an adjustment becomes really necessary. The writer came across one case, in the course of an audit, where the bank reconciliation showed a surprisingly large number of outstanding cheques; it turned out, on enquiry, that not only had these cheques not been posted to the creditors concerned, but they had not even been signed. The accountant had merely drawn them and put the unsigned cheques in a basket, to be signed after the balancing date. It is clear that to enter a cheque as a payment in the cash book under circumstances of this sort is incorrect: the entry should be made under the date on which the cheques are actually put in the post.

Of course, if the Balance Sheet figure of "balance at bank" differs from that shown in the cash book the corresponding adjustment is necessary to preserve the "double entry" (though no entry need be made in the books themselves). In the case mentioned above the bank balance was shown as increased by the amount of the "imaginary" payments and the "sundry creditors" increased by the same amount.

One final remark: the reader should note the wording of the heading "Balance at Bank." "Cash at Bank" is often used, but this is not strictly correct: the item is not specifically represented by cash, and the accountant cannot know what cash the bank may have available.

Goodwill.—Several academic definitions of what is meant by goodwill are available, but none of them are entirely satisfactory. It is best, perhaps, to explain the term on the broad lines of practice, and to say that, in general, the purchaser of a goodwill acquires the right to represent himself as the successor to the business, and to enjoy every advantage attaching to the business, capable of transfer, that the former proprietor enjoyed. Thus the purchaser of goodwill acquires the trade name, trade marks, designs, patents, copyrights, etc., belonging to the business; he takes over the benefit of current contracts, agreements, leases, etc., and he acquires all the advantage accruing from the location, reputation, and organisation of the business. The actual concomitants of goodwill will vary with the particular business, but some, or all, of these elements will be present.

By its very nature, goodwill fluctuates in value, increasing as the profits of the business increase, decreasing as they fall. For sale purposes, the value of the goodwill is usually based upon a given number of years' purchase of the average annual profits, calculated over from three to five years of the most recent trading experience. The number of years' purchase varies, and depends upon the kind of business. From three to five years is a common basis of computation. It is becoming increasingly common to arrive at the value of goodwill on one of the following bases, which are more scientific than the rough-and-ready method already mentioned:—

Method (*i*): Assume that the value of the Net Assets (*i.e.* Assets *less* Liabilities) to be acquired is agreed at £180,000, and that the Average Profits available, before deducting the remuneration of the Partners or Directors (as the case may be), are £38,000. It is then necessary to ascertain the yield required on capital invested in the business, having regard to the risk involved, and thus to arrive at the return which the goodwill will yield. This can then be capitalised, *e.g.*:—

Average Profits	£38,000
Deduct: Remuneration of Partners or Directors, say	5,000
Profits available for interest on capital	33,000
Deduct: Interest at 15% on the Capital paid for the net assets (*i.e.* say 5% for pure interest and 10% for risk)	27,000
Leaving available for return on investment in goodwill (*i.e.* "super-profits")	£6,000

The investment in goodwill will have to bring in the same yield as the investment in net assets, since the risk is the same, so that goodwill can be capitalised at £40,000 which is the amount of capital on which £6,000 of profits will return 15%.

Method (*ii*): Assume the same facts as before:—

Average Profits	£38,000
Deduct: Remuneration	5,000
Leaving available as the reward for Capital	£33,000

If 15% is the minimum return required on capital invested in that class of business, a profit of £33,000 capitalises at £220,000. The purchaser should therefore pay £220,000 for the net assets of £180,000, *i.e.* he pays for goodwill the sum of £40,000. The goodwill of a professional business, depending as such a business does upon the personality of the previous practitioner, will clearly be less than that attaching to a trading business, in which the personal factor is of far less account. Again, goodwill based upon steadily increasing profits will be more marketable than goodwill based upon decreasing profits.

Goodwill rarely appears in a Balance Sheet unless it has been purchased. The duty of the Balance Sheet draftsman in this connection is to see that the asset is stated as a separate item at the amount at which it stands in the books, with the narration "at cost," or "at cost less amounts written off."

By S. 38 and Fourth Schedule, Part I (10) of the Companies Act, 1948, every prospectus issued by or on behalf of a company or of a person engaged or interested in its formation, and, by S. 48 and Fifth Schedule of the same Act, every statement in lieu of prospectus must state the amount paid for goodwill.

Unless the Articles direct that goodwill shall be written down, a limited company would appear to be under no legal obligation to reduce the cost price of this asset (*Wilmer* v. *McNamara*, [1895]).

The contention occasionally advanced that in all cases goodwill should be written down as a wasting asset, apparently on the ground that debts and death are the only certain things, is not very logical. The author has in mind a business well over a hundred years old and flourishing more vigorously than ever. On what basis should the goodwill of that business be estimated? Again, who can foretell the life of a goodwill, and who, therefore, can assess the instalments to be written off? It is suggested that changes in the value of goodwill cannot be treated on precisely similar lines to waste in connection with fixed assets, but must be dealt with in the light of actual circumstances. Goodwill may be written down as a means of retaining funds in the business, and so cheaply providing working capital, and where this course is desirable it is to be commended. But that is another matter. The writing down of goodwill, where no permanent depreciation of the asset has occurred, is tantamount to the creation of a secret reserve, since in normal circumstances goodwill is constantly being renewed in the very fact that profits are maintained. In the author's view it is impracticable to attempt to record the fluctuating value of goodwill, and its reduction below the original cost price is a matter of financial prudence rather than one of obligation.

Goodwill, of course, is not a banker's security, and in scrutinising a Balance Sheet, preliminary to considering whether to grant an advance, the banker wisely ignores the asset.

Any provision made for the reduction of the asset goodwill is *an appropriation of profits* and not a charge against them.

The case of *Stapley* v. *Read Bros., Ltd.*, (1924), is of considerable interest to accountants in connection with the subject of goodwill. An injunction was sought to restrain the defendants: (*a*) from distributing a dividend until the debit balance of the Profit and Loss Account had been discharged; (*b*) distributing as dividend profits originally applied to writing down the book value of assets and subsequently written back; (*c*) dealing with any unrealised profit resulting from an estimated appreciation in the value of capital assets.

Goodwill stood originally in the Balance Sheet at £140,000, and was subsequently written down by instalments out of profits to £51,000. A reserve of £61,000 was also created out of profits. Subsequently the balance of the goodwill was written off against this reserve, thus reducing the reserve to £10,000. By the year 1920, the reserve had been increased to £25,000, and a further £15,000 was transferred thereto from the balance of the current Profit and Loss Account (£33,000), making the balance £40,000. This balance of £40,000 was then distributed in the form of fully paid shares by way of a capital bonus.

But a period of bad trade was experienced, and at the close of the year 1922 there was a debit balance on Profit and Loss Account of £20,504 16*s*. 6*d*. A profit of £1,300 was made in the year 1923, but three years' preference dividends were in arrear. The directors proposed: (*a*) to pay the arrears of preference dividend out of current profits; (*b*) write back to reserve £40,000 of the amount written off goodwill; and (*c*) eliminate the debit balance (£20,505) of Profit and Loss Account.

The plaintiff did not contend that the goodwill was not worth at least £40,000, but that profits utilised to write down the book values of assets could not afterwards be written back, and be treated as available for distribution. Mr. Justice Russell said that in his view " the sole question was whether the Profit and Loss Account is to be treated as a continuous account so that no dividend could be declared out of one year's profits until any debit to Profit and Loss in respect of prior years had been made good." In his opinion it was not so to be treated. If £40,000 had been carried to reserve from profits it could have been subsequently distributed as dividend. Did it make any difference if the company, instead of carrying that sum to reserve, utilised it to write down the value of goodwill? Had the company permanently capitalised those profits so as to disentitle it to restore them to reserve? The shareholders had approved the directors' previous reports and proposals, but they had not bound themselves to give up their claims to the profits that had been carried to reserve and employed to eliminate goodwill. In brief, those profits had not been permanently capitalised. The injunction applied for was refused.

Machinery and Plant.—The various methods employed to meet waste in connection with this asset have been discussed (see pp. 41–47). Whichever method is adopted, the result to be ensured is that the asset shall be stated in the Balance Sheet not at its market value but at a figure that represents its unexpired capital value to a going concern, *i.e.* " at cost " (if new), or at cost less depreciation, in other cases. Occasionally, one finds that this asset is stated at its original cost, and on the liabilities side of the Balance Sheet there appears a Depreciation Fund, representing the accumulated provision made for depreciation to date. This method cannot be recommended. It is better to show the value of the asset *net* on the assets side. Its present book value can then be seen at a glance. See also p. 95 as to other methods of stating this asset.

Where the plant is extensive and of various kinds, a Memorandum Plant Ledger, or Register in the form shown on p. 98, should be kept. Such a record is of great value as a check upon the provision made for waste, and is also useful when making claims for allowances in this connection in respect of Income Tax.

In reviewing a Balance Sheet the loan creditor will eliminate plant which is fixed to the building if the premises are mortgaged. He will also be at pains to depreciate any machinery which is special to the trade carried on, and will ignore assets partly paid for under the hire-purchase system.

Presentation of Fixed Assets in Balance Sheet. We will consider plant and machinery as a typical example, but other types of fixed assets will be dealt with in a precisely similar manner. Assuming that we are considering an examination question the student must first make sure whether the Balance Sheet he is preparing is or is not one for presentation to the members under the Companies Act; the wording of the question should make this clear, but should it not do so it would be wiser to assume that the examiner requires the Balance Sheet to comply with the Act.

Let us assume the following facts:—

(1) The accounting year ends on December 31, and we are considering the Balance Sheet to be drawn up as on December 31, 1950.

(2) At December 31, 1949, the total value of plant and machinery was: cost £50,000, aggregate depreciation to that date £19,000, net value £31,000.

(3) During 1950 plant which had cost £3,000 and in respect of which £2,300 aggregate depreciation had been written off up to 1949 was sold. Assume that the profit or loss on sale has been transferred to revenue.

(4) During 1950 new plant has been bought at a cost of £7,000.

(5) £4,000 is to be provided for depreciation in 1950, *in respect of plant on hand at the end of that year.*

We accordingly calculate that:—

(*a*) The cost of plant on hand at the end of 1950 is £50,000 less £3,000 plus £7,000, *i.e.* £54,000.

(*b*) The aggregate depreciation, *before* making the provision for 1950, is £19,000 less £2,300, *i.e.* £16,700. After providing the £4,000 further depreciation for 1950 the aggregate depreciation becomes £20,700.

(*c*) The net value for Balance Sheet purposes is therefore £33,300.

The question is now how to set out these facts in the Balance Sheet. The answer will depend to a considerable extent on whether or no the Balance Sheet is to comply with the Companies Acts. If the answer to this question is no (as for instance, if we are dealing with the accounts of a partnership) the following would suffice:—

	£	£
Plant and Machinery:		
As per last balance sheet	31,000	
Plus additions at cost, less sales at book value	6,300	
	37,300	
Less Depreciation written off	4,000	33,300

If the Balance Sheet (with appropriate alterations in dates) had been for publication under the Companies Act, 1929, the above would have sufficed, provided the following words had been inserted under the heading, "At cost, less depreciation." But to comply with the Companies Act, 1948, something quite different is necessary. The minimum information required for compliance with this Act would be:—

	£	£
Plant and Machinery:		
At cost	54,000	
Less aggregate depreciation	20,700	
		33,300

Note that these figures do not "tie up" with the corresponding figures for the previous year, but this is not necessary. If it is desired to show the connection with the figures for the preceding year (and many companies like to do this) there are several methods possible, one of which is the following:—

	£	£	£
Plant and Machinery:			
At cost: per last balance sheet		50,000	
Additions since	7,000		
Less sales	3,000		
		4,000	
		54,000	
Less depreciation written off: per last balance sheet	19,000		
Less depreciation on plant sold	2,300		
	16,700		
Add, provided this year	4,000		
		20,700	
			33,300

It is important to note that the "depreciation" shown as here provided is only the depreciation provided in respect of plant *still on hand at the end of the year*. If, as might well be the case in practice (or in an examination question for the matter of that), some depreciation had also been provided in respect of the plant which was sold during the year, then the *total* depreciation provided during the year, which is the figure shown in the published Profit and Loss Account (or possibly included there with depreciation of other fixed assets) would have exceeded £4,000 by the amount in question.

We cannot leave the subject without dealing with the situation (envisaged and allowed for by the Act of 1948) where the cost of the plant bought before 1948 cannot be ascertained "without unreasonable expense or delay." To consider this we will take the figures already given on p. 94 and suppose that:—

(6) Of total of £50,000, £32,000 represents the book value (as on December 31, 1947) of plant bought before December 31, 1947 and still in use at December 31, 1948, while the balance of £18,000 represents the cost of additions during 1948 and 1949.

(7) The plant sold in 1950 realised £900; further, it had been purchased before 1948, and there is no record of its cost. The figures given under (3) above therefore do not apply.

The "net book value" of the old plant is now (at the end of 1950) £31,100.

(8) In substitution for the figures for aggregate depreciation previously assumed, let us imagine that £8,500 depreciation has been provided in 1948 and 1949 (together), this including depreciation on both the "old" and the "new" plant, and that of this total £350 is considered as applicable to the plant sold in 1950.

We can see that, since this £350 relates to plant which at the end of 1950 is no longer in the company's possession, it must be deducted when arriving at the "aggregate depreciation" at that date. Further, the plant shown at "net book value" must be decreased by both the proceeds of sale, £900, and by this £350. In effect, though this can be no more than an estimate, £1,250 is taken as being the "net book value" on December 31, 1947, of that part of the plant which was sold in 1950. If the directors have reason to consider that this figure of £1,250 is seriously wrong their proper course (though apparently there is no compulsion under the Act) would be to adjust the "net book value" accordingly, by reference to the estimated profit or loss on sale. We will assume that, for whatever reason, this is not done in the present case. The following entry in the Balance Sheet, giving the facts as assumed, would comply with the Act of 1948:—

	£	£
Plant and Machinery:		
At net book value on December 31, 1947, less sales since	30,750	
At cost	25,000	
	55,750	
Less aggregate depreciation written off since December 31, 1947	12,150	43,600

A second method, which has much to recommend it, is to make a clean distinction between the present values of the plant shown at cost or at "net book value" respectively. This involves providing depreciation separately in respect of these two portions of the plant. Suppose now that of the £8,500 depreciation provided in 1948 and 1949 £4,700 was allocated to the old plant (taken at "net book value") and £3,800 to the plant bought in 1948 and 1949. Suppose also that of the £4,000 to be provided in 1950, £2,200 relates to the old plant and £1,800 to the new.

Dealing first with the "old" plant, the "net book value" at the end of 1950 is £32,000 less £1,250, *i.e.* £30,750 (as before). The aggregate depreciation (since 1947) on the "old plant" is £4,700 less £350 plus £2,200, *i.e.* £6,550.

As regards the "new plant," the cost is £25,000, and the aggregate depreciation £3,800 plus £1,800, *i.e.* £5,600.

The balance sheet entry could accordingly be:—

	£	£	£
Plant and Machinery:			
At net book value on December 31, 1947	30,750		
Less aggregate depreciation provided since	6,550	24,200	
At cost	25,000		
Less aggregate depreciation	5,600	19,400	
			43,600

It may possibly be an objection that this method fails to disclose the total "aggregate depreciation" as a single figure. This is true, though an answer is that the facts are disclosed as fully as possible, and if anyone wishes to know the grand total of depreciation it is only necessary to add together its two component parts, viz. £6,550 and £5,600. This difficulty may, however, be got over, if desired, by using the "columnar" method, now becoming increasingly popular, *e.g.*:—

	Cost, etc.	*Aggregate Depreciation.*	*Net.*
	£	£	£
Plant and Machinery:			
At net book value, December 31, 1947	30,750	6,550	24,200
At cost	25,000	5,600	19,400
	£55,750	£12,150	£43,600

The other types of fixed assets can also be dealt with in these columns in the same way, so that the final total of the first column (which would be "ruled off" at the foot of "fixed assets" section of the Balance Sheet) would show the total cost (including "net book value" figures where appropriate) of all the fixed assets owned by the business. Similarly, the final total of the second column would disclose the aggregate depreciation provided in respect of fixed assets of all types.

A further extension of the same method is to use additional columns in which to set out separately (for instance) last year's figures (at cost), additions less sales, last year's figures of aggregate depreciation, and depreciation provided this year. Numerous variations are possible, as inspection of the published accounts of a number of businesses will soon disclose.

Loose Tools, etc.—Depreciation of this asset by ordinary methods is impracticable. Many of the tools may be made by the firm's own workmen, and constant additions, losses, scrapping, and "borrowing" will vary the quantity of the stock held. Actual valuation is the only safe method to adopt. The value of horses, livestock, moulds, and similar assets should also be ascertained by periodical valuation. In all these cases, fixed percentage depreciation is often misleading.

Trade Marks, Patterns, Dies, Drawings, etc.—It is difficult to deal with these except on the basis of cost, subject to periodical survey, in order to prevent obsolete trade marks, patterns, etc., being included. Trade Marks can be grouped with goodwill and patents in the Balance Sheet.

Patents.—The protection afforded by a patent lasts for sixteen years from its date. But the life of a patent may be extended by order of the High Court, on petition by the patentee, where sufficient cause for extension is shown. The original cost of the patent, if purchased, together with all fees paid in respect thereof should be written off over the life of the patent or earlier. Similarly, all expenses and the costs of experiments in connection with the invention patented should also be written off within its life. This is the broad theory, but it may

PLANT LEDGER.

Particulars of Machine : *Automatic Drill.*
Erected in : *Machine Shop.*

Date Purchased : *December* 31, 19..
Expected Life : *Ten Years.*

Makers : *Hard, Steel & Co.*
Residual Value Estimated at £200

Date.	Particulars.	[illegible]	Repairs.	Renewals.	19.. Depreciation written off.	19.. Book Value.	19.. Depreciation written off.	19.. Book Value.	19.. Depreciation written off.	19.. Book Value.
		£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
19.. Dec. 31	*Cost of Machine purchased from Porter & Co. at this date* .	5,000 0 0			480 0 0	4,520 0 0				
19.. Dec. 31	*Additions during the year* . . .	100 0 0								

Note.—The Repairs column is employed as a record of the expenses incurred in connection with each machine. As this expense is charged to Revenue it does not, of course, form part of the book value.

(*Investment Ledger.*)

ARCADIA 5% GOLD BONDS.

Numbers of Bonds..............

Interest payable June 1 and December 1.

Dr.

Date.	Details.	Nominal. £	s.	d.	Interest. £	s.	d.	Principal. £	s.	d.
19.. Dec. 1	To Cash: 10 Bonds of £100 each at par, and expenses	1,000	0	0				1,005	0	0
June 30	,, Profit and Loss (Interest) Account				20	0	0			
,, 30	,, Profit on Sale of Investments Account							45	10	0
		£1,000	0	0	£20	0	0	£1,050	10	0
19.. June 30	To Balance brought down	500	0	0				502	10	0

Cr.

Date.	Details.	Nominal. £	s.	d.	Interest. £	s.	d.	Principal. £	s.	d.
19.. June 1	By Cash: Half-year's interest £25 0s. 0d. *Less* Tax at 4s. 5 0 0				20	0	0			
,, 5	,, Cash: Sale of 5 Bonds at £110, *less* expenses	500	0	0				548	0	0
,, 30	,, Balance carried down at cost	500	0	0				502	10	0
		£1,000	0	0	£20	0	0	£1,050	10	0

have to be modified to fit the circumstances, *e.g.* in the event of the complete failure of the patent.

Copyrights.—These extend for fifty years after the author's decease. It is difficult to value this sort of property, since the value of a copyright may last long or quickly wane. Periodical survey and valuation is the only safe method.

Furniture, Fixtures, and Fittings. — Office furniture may last a long time, and possess considerable second-hand value. But Fixtures and Fittings should be much more heavily depreciated than Office Furniture, since these are usually worth little more than firewood when it comes to alteration of premises, removal, or sale. Particularly is this the case if they are specialised to the trade. If the premises are leasehold, some of the fittings will become the property of the landlord at the expiration of the lease, and particular care is needed in such cases to eliminate the asset from the books during the life of the lease.

Investments.—Investments cannot be said to depreciate in the ordinary sense, that is owing to wear and tear, but they may fluctuate in capital value. If investments are fixed assets held for the purpose of producing revenue, fluctuations in value may be ignored, provided that they are not permanent. The basis of valuation, cost or market price, must be stated, and, where the value is stated at cost, a note must appear on the Balance Sheet of their aggregate market value. Special reserves are often created to meet actual or possible fluctuations in the value of investments, especially when the investments held are heavy. Investments which represent a reserve fund should be separately stated in the Balance Sheet. If these investments are less in amount than the reserve, it indicates that the balance of the fund is comprised in the general assets of the business. Trade investments, *i.e.* shares held for trade purposes, or shares in associated companies, must also be separately stated. If any liability for uncalled capital attaches to investments, a note of the fact must be made in the Balance Sheet.

A separate ledger should be kept to record investment holdings and a separate account for each investment, ruled as shown on p. 99.

Some companies (*e.g.* Assurance Companies) are under statutory obligation to marshal their investments in the Balance Sheet under specific headings. As stated on p. 84, Schedule VIII, para. 8, requires that investments shall be subdivided into the following groups: (*a*) trade investments, (*b*) quoted investments other than trade investments, and (*c*) unquoted investments other than trade investments. Where investments are held in subsidiary companies they must be stated separately as such, although only the aggregate need be stated, *i.e.* it is not necessary to show the holding in each subsidiary company.

Interest Accrued Due.—Interest on debentures, mortgages, and similar fixed-interest investments is frequently apportioned, and the amount applicable to the period covered by the accounts is taken credit for in the Profit and Loss Account, a like amount being scheduled as an asset in the Balance Sheet. This is perfectly in order, though not considered obligatory. On the other hand, dividends, even on preference shares, should *never* be anticipated unless at the time the accounts are being prepared they have actually been declared. Even then it is better not to apportion them, though if such a dividend is in respect of a period ending not later than the Balance Sheet date it is permissible to bring in the whole as a dividend receivable.

Mines, Quarries, etc.—It is not the usual practice in this country to provide for the wasting of this kind of property consequent upon the gradual exhaustion of the mineral or other contents; and mining and similar companies are under no legal obligation to keep their capital intact. "If a company is formed to acquire or work property of a wasting nature, *e.g.* a mine, quarry, or a patent, the capital expended in acquiring the property may be regarded as sunk and gone" (Lindley, L.J., in *Lee v. Neuchatel Asphalte Co., Ltd.*, [1889]). No deductions for waste in respect of such property are allowed for income-tax purposes. If it is desired to make provision for waste, the yearly amount to be set aside should be based upon: (*a*) the price paid for the mine and its estimated total contents; (*b*) the quantity of the product extracted during the current period; and (*c*) the estimated residual value of the land. The estimated cost value of the tonnage raised during the year gives the amount of the provision to be made.

Stock-in-Trade.—It has already been stated that the basis of valuation must be consistent period with period. There is a classic accounting rule that stock should be valued at cost or at market price, whichever is the lower. But this axiom needs qualification. If the fall in market value is temporary only, there is no need to reduce the book value of stock held by a going concern. In many cases "cost" may legitimately include freight, duty, and carriage. Deterioration due to damage, change of fashion, and similar causes must be allowed for. In short, only permanent diminution in value need be recognised. But profits must not be anticipated by the over-valuation of stock. Goods out on approval, and stock in transit to agents, must be valued on the same basis as stock in warehouse, and not be treated as sales.

Large differences between opening and closing stocks, or those of previous trading periods, should be investigated. Such variations may be due to: (*a*) inaccurate stocktaking; (*b*) alteration in the basis of valuation; (*c*) overstocking; (*d*) changes in the prices of raw materials; (*e*) sales failing to keep pace with manufacture; (*f*) faulty buying. Whatever the cause it should be traced. Allowing for fluctuations in turnover, there should be reasonably close correspondence between opening and closing stocks for different periods, and if there is not an explanation is called for.

The Balance Sheet should state by whom the stock has been valued, *e.g.* thus: *Stock at December* 31, 19...., £— —*s.* —*d.* (*as valued by Departmental Managers*).

Work in Progress.—The basis upon which this asset should be valued and the shortcomings of examination candidates when dealing with such items have been dealt with on p. 23.

Sundry Debtors.—The balances of the Sales Ledgers should be extracted on separate sheets, the total of which is carried into the main Trial Balance. There will probably be some small credit balances arising from over-payment, unclaimed allowances, etc. These, strictly speaking, should be added to the total balance of the Sundry Creditors. In some instances, provision is made for doubtful debts by assessing each account where provision is necessary, but it is the more usual practice to reserve a fixed percentage on the total debtors. A reasonably constant ratio between sundry debtors and turnover should exist, allowing for the usual run of trade credit. Care must be taken that all trade discounts and returns have been dealt with; and trade and other loans should be stated in the Balance Sheet separately from ordinary trade debtors. Advances to and amounts due from subsidiary companies must be stated as a separate total.

The amount of any loans made during the period of the Profit and Loss Account, either by the company or by any other person under a guarantee from or on a security provided by the company to any director or officer of the company, including any loans repaid during the period; also any such loans made previously and still outstanding, must be shown on the Balance Sheet, unless it is part of the ordinary business of the company to lend money, and the loan was in the ordinary course of business (*e.g.* a bank) or the loan was one not exceeding £2,000 to any employee of the company, and is certified by the directors to have been made in accordance with the company's practice with respect to loans to its employees. So far as concerns directors the above applies only to "exempt private companies"; loans, etc., to directors of other companies are now absolutely prohibited (S. 190). There must be stated separately on the Balance Sheet the outstanding amount of any loan made for the purchase by trustees of fully-paid shares in the company to be held by or for the benefit of employees, or made to employees other than directors with a view to enabling them to purchase fully-paid shares in the company to be held by themselves by way of beneficial ownership.

In addition to provision for doubtful debts, a provision should be created in connection with foreign debtors against possible losses due to fluctuations in exchange. It has already been stated that, in the majority of cases, no provision for discount is deducted from the book debts. The loan creditor must, however, remember that if forced realisation supervenes, the asset will be reduced by such discounts as are claimable.

Development Expenditure.—Companies working mines, collieries, plantations, and similar property are frequently obliged to consume considerable time and capital in order to bring the property to the revenue-earning stage. During the work of development, practically all expenditure on development is capitalised. The sinking of shafts and driving of adits and levels, pumping, tree-planting, and road-making afford examples of development expenditure. There can be no objection to treating such expenditure as an asset, provided that, when the venture reaches the revenue-earning stage, steps are taken to write off the expenditure within a definite period of time. The accountant will probably need expert assistance before he can accurately adjust such expenditure as between capital and revenue.

In a case where a public-utility company constructed works by the aid of its own employees it was allowed to add to its capital expenditure on actual constructional work, the interest and dividends paid on loans and preference shares raised to pay for the construction (*Bardwell* v. *Sheffield Waterworks Co.*). Interest during construction can also be paid under the conditions laid down in The Companies Act, 1948, S. 65.

Deferred Revenue Expenditure.—Expenditure such as Preliminary Expenses, Share and Debenture Issue Expenses, Debenture Discount, Removal Expenses, Repairs (if abnormally heavy), and the like must be carefully reviewed, and, as explained before, may be "held up" as an asset legitimately, if written off over a reasonable period. It is assumed in such cases that benefits will accrue in succeeding years from the expenditure, and so these years should bear their proportion of the burden. It has already been explained that suspense expenditure such as Insurance, Rent, Rates, and Advertising paid in advance may be apportioned over the period they cover. All assets of this kind are, of course, worthless from the creditor's or banker's point of view. Certain of the items must be shown separately (see p. 83.)

LIABILITIES.

Liabilities Generally.—As we have seen, the values placed upon assets are necessarily to some extent based upon personal opinion. But liabilities, except contingent liabilities, are capable of exact statement.

The various liabilities must be set out and classified under appropriate headings. It is important to distinguish long-term liabilities (*e.g.* debentures or fixed loans) and short-term or current liabilities, and it must not be forgotten that if any liabilities are secured (otherwise than by operation of law) the fact must be stated. Under the heading "current liabilities" must be included: (*a*) all amounts immediately due for payment, whether in respect of goods (trade creditors) or expenses or services (*e.g.* rent or directors' fees) and (*b*) the due proportion of expenses accrued so far as they can be computed with "substantial accuracy." Any amounts which cannot be so computed, *i.e.* which are rather of the nature of rough estimates, must be set out separately under the heading "provisions." Under the general heading of current liabilities will also be included, under appropriate sub-headings, the company's current taxation liability and the dividend(s), if any, proposed to be paid. The total of any bank loans or overdrafts *must* also be stated separately.

Capital.—It is usual to head the liabilities with a statement of the capital, although, in theory, outside liabilities should first be dealt with, since the capital item is the balance or net worth of the proprietor of the business. The statement of capital in the Balance Sheet of a partnership has been dealt with in Chapter VII.

The nominal, subscribed, and paid-up capital of a limited company must be clearly stated in order that the uncalled capital, if any, may be seen. If redeemable preference shares are outstanding, they must be stated separately with a note as to the date on or before which they are, or are to be liable, to be redeemed. Calls paid in advance, unpaid calls, and any shares that have been forfeited, together with the amounts paid up on them, must be separately stated. If any shares have been issued at a discount, so much of the discount as has not been written off must be separately stated on the assets side of the Balance Sheet.

If capital has been issued under S. 65 of the Act of 1948 the Accounts must disclose the share capital on which, and the rate at which, interest has been paid out of capital during the period (see p. 416).

Debentures.—These must be stated separately. Any interest accrued on them will be included under the current liabilities, and will not as a rule be shown separately. If the debentures have been issued at a discount, the discount, less any amount written off, will appear on the Assets side of the Balance Sheet. Debentures issued as collateral security for a bank loan are frequently incorrectly treated by examinees. The only entry necessary in this connection is as follows:—

Loan from Bankers (secured by the issue of £24,000 5% Mortgage Debentures)	£20,000 0 0

The debentures are not extended in the outer column as a liability; they are a contingent liability, and can be enforced only if the interest on the loan is in arrear. When the debt is repaid, the debentures are released.

The usual method of stating capital and debentures in a company Balance Sheet is as follows:—

		£	s.	d.	£	s.	d.
Capital:—							
Nominal—							
100,000 5% Preference Shares of £1 each		100,000	0	0			
150,000 Ordinary Shares of £1 each		150,000	0	0			
		£250,000	0	0			
Issued—							
100,000 5% Preference Shares of £1 each, fully paid		100,000	0	0			
100,000 Ordinary Shares of £1 each, 10*s*. per share called up	£50,000						
Less Calls in arrear	500						
	49,500						
Add Calls paid in advance	500	50,000	0	0	150,000	0	0
Debentures:—							
500 5% Debentures of £100 each					50,000	0	0
Share Premium Account					2,500	0	0

Where a company has power to reissue debentures which have been redeemed, particulars with respect to the debentures which can be so re-issued must be included in the Balance Sheet, *e.g.*:—

	£	£
1,000 6% *Debentures of £50 each*	50,000	
Less: 200 *Debentures which have been redeemed and are available for reissue*	10,000	£40,000

Capital Redemption Reserve Fund.—If Redeemable Preference Shares have been redeemed out of profits, an amount equal to the profits so used must be set aside to a Capital Redemption Reserve Fund which must appear separately on the Balance Sheet.

Sundry Creditors.—Trade creditors may either be set out separately or combined with accrued liabilities for normal expenses, as desired. They must *not*, however, be combined with loans or bank overdrafts. It is permissible, if desired, to include bills payable with the trade and other creditors, but if this is done care must be taken that a suitable heading is used, *e.g.* (under the main heading "Current Liabilities") "Sundry Creditors and Bills Payable." For examination purposes students are recommended always to separate trade creditors, expenses accrued, and bills payable, but they must all be shown as subdivisions of "Current Liabilities." If any securities or charges are held by creditors, the fact must be noted. Amounts due to subsidiary companies must be shown as a separate total.

Contingent Liabilities.—These undetermined liabilities should be indicated in the Balance Sheet in the form of notes. If any amounts are set aside towards meeting such liabilities they must be shown under the heading of "Provisions," giving sufficient indication of the nature of the liabilities in question.

Maintenance Fund.—A reserve under this heading appears sometimes on the liabilities side of a Balance Sheet. The method of creating and operating funds of this nature has been explained on p. 62.

Reserves.—These have already been dealt with. They should be stated separately, and the reason for their creation be indicated, if they have been made for a specific purpose, *e.g.* to provide for a known contingency; or for the equalisation of dividends, etc.

PREPARATION OF ACCOUNTS IN EXAMINATION WORK.

Book-keeping examination papers almost invariably contain a long "working question," which requires the preparation of a Trading (Manufacturing) Account, a Profit and Loss Account, and a Balance Sheet. The answering of this question takes up a large proportion of the time allotted for working the paper as a whole, and naturally carries a high percentage of the total marks attainable. Indeed, in the majority of examinations, a "pass" cannot be secured unless this question is well answered. In the author's experience, many candidates come to grief over this question, either (*a*) because they fail to devote sufficient time to it, or (*b*) because they attack it without method, and therefore without safeguards against error.

As a general rule, a question of this kind begins with a preamble detailing particulars regarding such matters as the issue of capital and debentures, forfeited shares, unpaid calls, and the like. Then follows a schedule of balances, and, at the end, a list of adjustments, or "instructions," to be taken into consideration when preparing the accounts.

If the paper is a long one, or the candidate is a slow worker, this may be the most practical way to proceed. The ideal method, however, if time permits, is to draw up a trial balance, if only a rough abbreviated one, and then draft journal entries for the adjustments. The trial balance will avoid the risk of mistaking debit balances for credits or vice versa, and the journal entries should ensure that both debit and credit aspects of each transaction are dealt with.

A convenient short cut, equivalent in effect to the preparation of a full trial balance is: (*a*) to ascertain the total of all the balances, which can normally be done on the question paper itself, and (*b*) to list on a separate piece of paper the credit items, which are usually less in number than the debits. The total of this list should be exactly half the grand total, and it will be seen that the ascertainment that this is actually the case is equivalent to the construction of a full trial balance.

By way of illustration, consider the following typical examination question:—

Rindges, Ltd., was registered with a nominal capital of 300,000 shares of £1 each. 200,000 shares were issued at a premium of 2*s*. 6*d*. per share, and were fully subscribed, and 12*s*. 6*d*. per share, including the premium, was duly paid up, with the exception of a call of 2*s*. 6*d*. per share on 4,000 shares which remained unpaid.

In addition to the above, the following balances were extracted from the books as on March 31, 19...:—

Plant and Machinery, £32,000; Manufacturing Wages, £36,842; Machinery Repairs, £1,286; Freehold Factory, £62,580; Repairs to Factory Buildings, £794; Rates (Factory, £942; Office, £120), £1,062; Fire Insurances (Factory, £920; Office, £64), £984; Employers' Liability Insurance, £1,262; Directors' Fees, £1,000; Discount Account (Credit Balance), £214; Office Furniture, £900; Transfer Fees, £62; Apprentices' Premiums, £600; Carriage (Inwards, £842; Outwards, £1,342), £2,184; Preliminary Expenses (Balance), £780; Office Expenses, £1,321; Office Salaries, £5,228; Cash in hand, £1,258; Power and Light (Factory), £995; Gas and Electricity (Office), £72; Cash at Bank, £12,641; Profit and Loss Account (Credit Balance from last year), £6,484; Goodwill, £25,000; Stock at beginning of year (Raw Materials, £6,280; Work in Progress, £1,250; Finished Goods, £4,861), £12,391; Interim Dividend paid July 1, 19..., £5,000; Loose Tools (at beginning of year), £2,960; Purchases (Net), £39,462; Sales (Net), £123,872; Sundry Debtors, £36,842; Sundry Creditors, £29,112.

You are required to prepare Manufacturing and Profit and Loss Accounts for the year ended March 31, 19..., and a Balance Sheet as on that date (NOT IN STATUTORY FORM).

When preparing these accounts, the following matters must be taken into consideration: (*a*) Stock was valued, as on March 31, as follows—Raw Materials, £4,401; Finished Goods, £3,721; Work in Progress, £2,528. (*b*) Loose Tools were valued at £2,200. (*c*) The five apprentices, from whom £600 in fees had been received, had served only one of the three years of their indentures. (*d*) 10% depreciation is to be written off Machinery and Plant, and 5% off Office Furniture. (*e*) The balance of the Preliminary Expenses Account is to be written off. (*f*) Provide £500 for discount on Sundry Debtors' Accounts, and £1,000 for Bad and Doubtful Debts. (*g*) The following had accrued due, as on March 31: Wages, £360; Salaries, £220; Directors' Fees, £250.

As is usual with this type of question, the preamble contains details of transactions that form a necessary part of the Trial Balance. The first step, therefore, is to start the schedule of balances with these particulars as follows:—

	£	s.	d.
Share Capital: 200,000 shares of £1 each, 10*s*. called up	100,000	0	0
Premium on above, 2*s*. 6*d*. per share	25,000	0	0
Calls in arrear, 2*s*. 6*d*. per share on 4,000 shares	500	0	0
The next step is to add the schedule of balances that appear in the question. The total of these amounts to	445,188	0	0
	£570,688	0	0
One-half of this total must, of course, represent the totals both of the debit and the credit balances	£285,344	0	0

The analysis of the balances as between debits and credits is the next step: and this is quickly effected by first selecting the credit balances, since these are always few in number and readily recognisable. They are as follows:—

	£	s.	d.
Share Capital	100,000	0	0
Premiums Account	25,000	0	0
Discount (Credit Balance)	214	0	0
Transfer Fees	62	0	0
Apprentices' Premiums	600	0	0
Profit and Loss Account (Credit Balance from last year)	6,484	0	0
Sales	123,872	0	0
Sundry Creditors	29,112	0	0
	£285,344	0	0

The remaining balances must perforce be debits. By this process, therefore, we obtain an accurate Trial Balance.

The remaining loopholes for error reside in the adjustments or instructions. The wise examinee should, if time allows, draft journal entries setting forth these adjustments, somewhat as follows:—

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
Stock Account (B/S)	Dr.	10,650	0	0			
To Manufacturing Account					10,650	0	0
(Final Stock.)							
Depreciation (Profit and Loss Account) . .	Dr.	4,005	0	0			
To Machinery and Plant Account (B/S) . .					3,200	0	0
„ Office Furniture (B/S)					45	0	0
„ Loose Tools (B/S)					760	0	0
(Depreciation written off.)							
Apprentices' Fees (Manufacturing Account) .	Dr.	400	0	0			
To Sundry Creditors (B/S)					400	0	0
(Fees carried forward.)							
Profit and Loss Account	Dr.	750	0	0			
To Preliminary Expenses (B/S)					750	0	0
(Balance written off.)							
Provisions (Profit and Loss Account) . . .	Dr.	1,500	0	0			
To Sundry Debtors (B/S)					1,500	0	0
(Discounts and Bad Debts.)							
Sundries :	Dr.						
Manufacturing Wages (Manufacturing Account) .		360	0	0			
Salaries (Profit and Loss Account) . . .		220	0	0			
Directors' Fees (Profit and Loss Account) . .		250	0	0			
To Sundry Creditors (B/S)					830	0	0
(Amounts outstanding.)							

As an alternative to setting out journal entries, since this may involve time that can ill be spared, some candidates like to mark the adjusting figures against the relevant items in the question paper. The figures to be added are marked with a + sign, and figures to be deducted with a – sign. Finally, all figures, both the printed ones and the candidate's adjustments, are "ticked" against the answer to ensure that everything has been dealt with: if all items are correct there should be no figures "unticked".

If the question contains information which cannot be noted in the form of a journal entry, *e.g.* the existence of a contingent liability in respect of uncalled capital, investments held, bills discounted, etc., the examinee should make sure of dealing with the point or points by marking his question paper in the margin as follows: "*Note Contingent Liability(ies) in Balance Sheet.*"

A further "tip" which many candidates find useful is to mark each item in the list of balances "T", "P", or "B" according to whether they should appear in the answer (with or without modification) in the Trading Account, Profit and Loss Account or Balance Sheet.

The Trial Balance and the journalised adjustments having been drafted as above, a sure foundation is laid for the preparation of the accounts required by the question, and, in the absence of gross carelessness, these precautions will ensure accounts that "balance." Failure

Messrs. Rindges, Ltd.

MANUFACTURING ACCOUNT FOR THE YEAR ENDED MARCH 31, 19..

Dr.

	£	s.	d.	£	s.	d.
To Stock						
Raw Materials	6,280	0	0			
Work in Progress	1,250	0	0			
Finished Goods	4,861	0	0			
				12,391	0	0
,, Purchases				39,462	0	0
,, Wages				37,202	0	0
,, Repairs (Machinery)				1,286	0	0
,, Repairs (Buildings)				794	0	0
,, Rates				942	0	0
,, Fire Insurance				920	0	0
,, Employers' Liability Insurance				1,262	0	0
,, Carriage				842	0	0
,, Power and Light				995	0	0
,, Balance carried to Profit and Loss Account				38,626	0	0
				£134,722	0	0

Cr.

	£	s.	d.	£	s.	d.
By Sales				123,872	0	0
,, Apprentices' Premiums				200	0	0
,, Stock –						
Raw Materials	4,401	0	0			
Work in Progress	2,528	0	0			
Finished Goods	3,721	0	0			
				10,650	0	0
				£134,722	0	0

Messrs. Rindges, Ltd.

(NON-STATUTORY) PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED MARCH 31, 19...

Dr.													Cr.
				£	s.	d.					£	s.	d.
To Rates				120	0	0	By Balance from Manufacturing Account				38,626	0	0
,, Fire Insurance				64	0	0	,, Discount Account				214	0	0
,, Directors' Fees				1,250	0	0	,, Transfer Fees				62	0	0
,, Carriage Outwards				1,342	0	0							
,, Preliminary Expenses				780	0	0							
,, Office Expenses				1,321	0	0							
,, Office Salaries				5,448	0	0							
,, Gas and Electricity				72	0	0							
,, Depreciation—	£	s.	d.										
Plant, 10%	3,200	0	0										
Furniture, 5%	45	0	0										
Loose Tools (valuation)	760	0	0										
				4,005	0	0							
,, Provision for Discount on Debtors				500	0	0							
,, Provision for Bad and Doubtful Debts				1,000	0	0							
,, Balance carried down				23,000	0	0							
				£38,902	0	0					£38,902	0	0
To Balance carried down				24,484	0	0	By Balance brought down				23,000	0	0
							,, Balance from last year	£6,484	0	0			
							Less Interim Dividend paid	5,000	0	0			
											1,484	0	0
				£24,484	0	0					£24,484	0	0
							By Balance brought down				£24,484	0	0

Messrs. Rindges, Ltd.

(NON-STATUTORY) BALANCE SHEET, MARCH 31, 19..

		£	s.	d.
Capital :—				
Nominal :				
300,000 Shares of £1 each	£300,000 0 0			
Issued :				
200,000 Shares of £1 each : 10s. per share called up	£100,000 0 0			
Less Calls in arrear	500 0 0	99,500	0	0
Premium on Shares		25,000	0	0
Sundry Creditors	£29,112 0 0			
Apprentices' Premiums	400 0 0			
Wages, £360; Salaries, £220; Directors' Fees, £250	830 0 0	30,342	0	0
Profit and Loss Account (Balance)		24,484	0	0
		£179,326	0	0

			£	s.	d.
Goodwill at cost			25,000	0	0
Freehold Factory at cost			62,580	0	0
Machinery and Plant at cost, *less* depreciation previously written off		£32,000 0 0			
Less Depreciation for year		3,200 0 0	28,800	0	0
Office Furniture at cost *less* depreciation previously written off		£900 0 0			
Less Depreciation for year		45 0 0	855	0	0
Loose Tools at cost, *less* depreciation previously written off		£2,900 0 0			
Less Depreciation for year		700 0 0	2,200	0	0
Stock :					
Raw Materials		£4,401 0 0			
Finished Goods		3,721 0 0			
Work in progress		2,528 0 0	10,650	0	0
Sundry Debtors		£36,842 0 0			
Less Provisions					
Discounts	£500 0 0				
Bad and Doubtful Debts	1,000 0 0	1,500 0 0	35,342	0	0
Cash at Bank		£12,641 0 0			
Cash in hand		1,258 0 0	13,899	0	0
			£179,326	0	0

to achieve this much-desired result appears to throw the inexperienced student into a state of panic, which lack of system in searching for the error does nothing to relieve.

As a first step, the items in the Trial Balance and the journal adjustments should be checked into the accounts. If this fails to locate the error, other tests can be applied. If the difference is a round sum, *e.g.* £10 or £100, it probably points to an error in arithmetic, *e.g.* in the additions of totals, or in the deductions of depreciations, reserves, etc.; or it may result from a carelessly placed figure, *e.g.* the figure 1, that has been reckoned in the wrong column, thus making a difference of 9, 90, 900 as the case may be. If the error is an uneven amount, it probably results from an omission, or from entering an amount twice over, in which case an item in the Trial Balance of the exact amount of the error should be sought. Another frequent error occurring in the hurry of examination work is the placing of an entry on the wrong side of the account, and then search for an amount half that of the " difference " should reveal the error.

Other common errors include (1) omitting to bring down the gross profit into the Profit and Loss Account; (2) entering the *opening*, instead of the *closing*, stock figure in the Balance Sheet; (3) calculating Reserve for Discount on Sundry Debtors *before* deducting the Bad Debt Reserve, whereas discount should be reserved only on the *good* debts; (4) where depreciation appears in the Trial Balance, it has *already* been deducted from the asset, if, therefore, it is desired to show the deduction in the Balance Sheet, the balance of the asset account, as given in the Trial Balance, must first be increased by the amount of the depreciation written off; (5) Some examinees appear to be so accustomed to exercises which result in a *profit*, that when they encounter an examination question resulting in a *loss*, they mechanically enter the debit balance of the Profit and Loss Account on the liabilities side of the Balance Sheet! Many failures result from this careless error.

The Accounts in their final form will appear as on pages 108, 109, and 110.

EXAMINATION QUESTIONS.

1. State points of difference between a Trial Balance and a Balance Sheet. (*Chartered Secretaries.*)

2. Is there any difference between a Balance Sheet and a Statement of Affairs? Submit a *pro-forma* example of the latter. (*Royal Society Arts.*)

3. Express fully your opinion upon the methods of grouping items under general headings in a Balance Sheet, and state what distinction you would make between realisable Assets and Debit Balances of a suspense nature. Give examples. (*Chartered Accountants.*)

4. State the principle upon which you would marshal the Assets and Liabilities in the Balance Sheet of a limited company, giving reasons for the basis you adopt (*Royal Society Arts.*)

5. Submit the credit side of a *pro-forma* Balance Sheet of a limited company. Divide the assets you select into " fixed " and " floating," and describe the difference, if any, in the obligation to provide for depreciation, or waste, in connection with the two classes of assets. (*Royal Society Arts.*)

6. What do you understand by the phrase " the working capital of a company "?

Set out with imaginary figures how it could be shown in accounts published for the information of shareholders. (*Incorporated Accountants.*)

7. Give the full and proper manner of stating and marshalling the following assets in the Balance Sheet of a limited company: Goodwill; Investments; Stock; Leasehold Premises; Fittings, Fixtures, and Furniture; Sundry Debtors; The B/L or D/O for part of the stock held by the Bank by way of security.

There is an uncalled liability on investments. (*Incorporated Accountants.*)

8. What evidence would you call for to establish the existence of the following assets included in a firm's Balance Sheet: (*a*) Land and Buildings; (*b*) Investments (including Registered War Loan); (*c*) Plant and Machinery; (*d*) Work in Progress.

What steps would you take to verify the values put on these assets?

9. You have been instructed by a client to report upon the Balance Sheet of X. Y., a customer, to whom he has been asked to give extended credit.

Describe the detailed enquiries you would make, before submitting your report, regarding the following items which appear as assets in the Balance Sheet: Freehold and Leasehold Works, £38,642; Patents and Trade Marks, £10,000; Machinery and Plant, £15,968; Lease and Stock (Foreign Branch), £3,472; Loose Tools, £1,576; Extraordinary Expenditure (Advertising carried forward), £5,000. (*Chartered Accountants.*)

10. Define: "Contingent Liability," "Collateral Security," and state how you would treat them in the Final Accounts of a firm. (*Incorporated Accountants.*)

11. "Sundry Creditors, including credit balances," is an item sometimes seen in accounts. What in your view are the dangers of such an item, and in what respect could it be used for wrong purposes? (*Incorporated Accountants.*)

12. When preparing a Balance Sheet, upon what principle should outstanding consignments be valued? (*Chartered Accountants.*)

13. How would you deal with the following items when closing the books and preparing the accounts of a limited company: (*a*) 150 Ordinary Shares of £1 each upon which 5*s.* per share has been paid, the shares being subsequently forfeited by the Directors. (*b*) £5,000 Arcadian Government 5% Stock, representing the investment of part of the Reserve Fund, purchased at 101 and now quoted at 95. (*c*) The Stock and Fixtures at the company's Exeter leasehold warehouse were valued, as at the close of the company's financial year, at £3,246 and £500 respectively. A few days later the warehouse was burnt out, and the Fire Insurance Company settled the claim in respect of both items for a lump sum of £4,000. (*Royal Society Arts.*)

14. Set out below is an extract from the first Balance Sheet of Rubber Plantations, Ltd.:—

BALANCE SHEET.

(CREDIT SIDE.)

		£
Property Account—		
Purchase Price as per Agreement with Vendor . .		100,000
Expenditure on development during the year	£25,862	
Less Rubber sold	981	24,881
London Office Expenses	1,484	
Less Transfer Fees	121	1,363
		126,244
Plantation Loans Outstanding		1,281
Cash at Bank		5,872
Bills Receivable		1,200
Preliminary Expenses		1,524
		£136,121

If you do not approve of the treatment of the figures set out in the above extract, criticise and amend it. (*Royal Society Arts.*)

15. The firm of A, B, & Co. has branches in London and Paris.

For 1951, A takes the whole of the London profit, and B manages the Paris branch for a salary of £1,500.

The expenditure in Paris commenced on January 1, 1951, and until December 31, 1951, was all for Buildings, etc., and Advertising. Some goods were, however, forwarded from London in December 1951 for sale in 1952. The goods were invoiced by London to Paris at market price, but charged to Paris in the London books at cost; Paris paid 4,000 francs duty thereon.

The balances on December 31, 1951, were as follows:—

	London Books. £	*Paris Books.* Fcs.
Creditors	7,700	80,700
Debtors	15,000	—
Buildings, etc.	10,000	250,000
Cash in hand and Balances at Bankers	4,000	76,000
Duty	—	4,000
Capital at January 1, 1951	(A) 20,000	(B) 100,000
Addition to Capital on August 31, 1951 .	—	(B) 210,000
Drawings	(A) 2,000	(B) 70,000
London	—	(Cr.) 160,000
Paris	(Dr.) 1,700	—
Stock	2,000	80,000
Profit	7,000	—
Advertising	—	70,000

Interest is to be taken at 5% on Partners' Capital and additions thereto, but not on drawings.

Rates of Exchange can be taken as follows:—

Average for 1951	70
Throughout December 1951	80
Remittances from London to Paris	80
B. paid in his Capital, 100,000 francs at 50 and 210,000 at	70
Fixed Assets were purchased at	50

Prepare the firm's Balance Sheet as on December 31, 1951.

16. The Company to which you are a Secretary has an Investment in A, B, & Co. 10% Debentures. From the following particulars prepare the Investment Account in the General Ledger:—

19... January 1. Purchased £5,000 Debentures at 98, brokerage and stamps £62, 10*s.*

March 31. Sold £2,500 Debentures at 101, brokerage £6 5*s.*

Interest is payable half-yearly on June 30 and December 31 and received on due dates. Income Tax at 4*s.* 6*d.* standard rate. Balance the Account at December 31. (Interest to be calculated by quarters, not days.)

17. A limited company obtained a loan of £15,000 from its bankers, and deposited 200 of the company's 6% Debentures of £100 each as security.

The company had previously made a public issue of 300 6% Debentures at 98, all of which had been subscribed and paid up.

How should these issues be stated in the company's Balance Sheet? (*Chartered Institute Secretaries.*)

18. United Investors, Ltd., derives its income primarily from dividends from holdings of stocks and shares of a considerable number of different companies.

Suggest a ruling for the Investment Ledger which will enable the accountant to trace easily the various dividends, etc., received over a period of years from any given holding. Assuming that the Company balances its books yearly on December 31, set out a *pro-forma* account showing the history of an investment made in May 1945, which paid dividends regularly in November and, in November 1947, made in addition a bonus distribution of shares, the holding being finally realised at a profit in February 1950.

How do you consider the profit on sale should be dealt with? (*London Chamber Commerce.*)

19. How would you deal with the following items when closing the accounts of a limited company for the year ended December 31, 19...?

(1) Issue on July 1, 100 Debentures at 97, repayable in ten years from date of issue at par. (2) Brokerage and Expenses incurred in connection with the issue of the above Debentures, £250. (3) £1,000 Reserved for Income Tax.

20. When preparing the Balance Sheets of the limited companies concerned hereunder, how should you arrive at the correct values to place upon the under-mentioned items:—

(*a*) Loans on Policies (advanced by an Assurance Company to its policy holders). (*b*) Rents on the companies' properties outstanding at the close of the financial year. (*c*) Preliminary Expenses, including a considerable amount due for underwriting a new issue of Capital. (*Royal Society Arts.*)

21. In 1952 Soleil d'Or, Ltd., purchased 300 Ruritania 6% Bonds repayable in 1960 at par. The Bonds were purchased at £108, and the expenses amounted to £96 4*s*.

Describe any entries you may consider necessary for dealing with the above investment in the books of the Company.

22. In a Balance Sheet, Investments sometimes appear valued at their current market price; in other cases they are stated at cost price. Which, in your opinion, is the more correct method? Give reasons for your reply, and state what course should be followed where the ruling market prices are greatly below the cost price. (*Incorporated Accountants.*)

23. Discuss briefly the case of *The Ammonia Soda Company, Ltd.*, v. *Chamberlain*, and state your opinion of the decision from an auditor's point of view. (*Chartered Accountants.*)

24. "The value of the goodwill of a business naturally fluctuates in sympathy with the commercial success of the undertaking."

Comment on this statement, and give your opinion as to whether such fluctuations should be recorded in the books and accounts of the concern. (*Royal Society Arts.*)

25. The Nominal Capital of Crawfords, Ltd., consisted of 250,000 shares of £1 each, of which 200,000 had been issued and fully paid up.

In order to bring the book value of their assets more in accord with present day values, the Company decided: (*a*) To add £20,000 to the Plant and Machinery Account. (*b*) To add £15,000 to the Freehold Factory Account. (*c*) To add £15,000 to the Goodwill and Trade Marks Account. (*d*) To issue the balance of the Ordinary Share Capital, amounting to £50,000, as a bonus of one fully paid share of £1 for each four shares held.

Submit the entries necessary to record the above transactions in the Company's books. (*Royal Society Arts.*)

26. It has been stated that "the decisions in the *Lee* v. *Neuchatel Asphalte Co.* series of cases relieve limited companies from the obligation to provide for depreciation on fixed assets."

What is your opinion of the statement from the point of view of: (*a*) The legal decisions referred to? (*b*) Commercial policy? (*Chartered Accountants.*)

27. Criticise the following Balance Sheet and re-draft it in the form you would be prepared to certify it. Taking assumed figures for the purpose of splitting any item, state concisely the information and explanations you would require as Auditor, and draft your Report to the Shareholders.

LIABILITIES.

	£ s. d.	£ s. d.	£ s. d.
Capital Issued:—			
6,027 6% Cumulative Preference Shares of £1 each		6,027 0 0	
3,100 Ordinary Shares		3,100 0 0	
		£9,127 0 0	
Deduct :—			
Uncalled Capital	162 10 0		
Calls Unpaid	207 10 0		
		370 0 0	
			8,757 0 0
Sundry Creditors on Open Accounts, Bills Payable, and Provision for Sundry Expenses			2,385 4 1
Suspense Accounts			259 11 5
Payments made by Customers for Work in Progress			113 1 0
Provision for Depreciation			138 16 0
Profit and Loss Account		1,960 7 3	
Less : Income Tax	£15 0 6		
Law Costs	60 6 0		
		75 6 6	
			1,885 0 9
			£13,538 13 3

ASSETS.

	£ s. d.
Machinery, Fixed and Loose Plant, Fittings, and Office Furniture	7,007 16 2
Sundry Debtors, including Loans to Directors	2,056 3 6
Loans	43 0 0
Stock, including Work in Progress	2,018 14 4
Insurances and Salaries paid in advance	248 7 4
Purchase Account	966 14 8
Forfeited Shares	50 0 0
Shares held in Trust	100 0 0
Cash at Bankers and in hand	1,047 17 3
	£13,538 13 3

28. The undermentioned assets are the property of the Reliance Boot Manufacturing Co., Ltd. How should they be valued for Balance Sheet purposes? (*a*) Twenty debentures of £100 each in the Southern Railway of America, representing the investment of the Reserve Fund. The debentures were purchased at par, but the market price has since fluctuated between 94 and 108, the former quotation being the mean market price as on December 31, 19..., the date upon which the Balance Sheet of the Reliance Boot Manufacturing Co., Ltd., is prepared. (*b*) Patents, £2,000. This amount represents the original cost of the patent rights in a welting machine. The grant of letters patent is dated January 1, 1946. (*c*) Goodwill, £5,000. This asset was purchased in 1945, at the price named, upon the formation of the limited company. The trading profits have steadily declined from £4,200 to £2,124 in four years.

29. The business of Bruce Bros. & Co. was registered as a limited company with a nominal capital of £400,000 divided into 4,000 shares of £100 each. 500 of these shares were issued as fully paid in part payment of the purchase price of the business. 3,200 of the remaining shares were allotted to the public, and fully called up. 25 4½% Debentures of £1,000 each were also issued and taken up.

On December 31 the following accounts remained open in the Company's books: Share Capital Account, £320,000; Fully Paid Shares Account, £50,000; Land and Buildings, £282,000; Sundry Creditors, £18,485; Investments, £8,450; Cash, £6,200; Preliminary Expenses Account (Balance), £1,250; Goodwill Account, £15,000; Calls in Arrear, £525; Debenture Account, £25,000; Stock Account (December 31), £9,000; Plant Account, £78,580; Sundry Debtors, £28,000; Reserve Fund, £8,000; Profit and Loss Account (undistributed balance), £7,520. Prepare a Balance Sheet as on December 31. (*London Chamber Commerce.*)

30. Roses, Ltd., was registered in 19... with a nominal capital of £100,000, divided into 50,000 Ordinary Shares of £1 each, and 50,000 6% Preference Shares of £1 each. The Company was formed to acquire an old-established business. The purchase price was agreed at £50,000, payable as to £15,000 in Ordinary Shares, £15,000 in Preference Shares (both fully paid), and £20,000 in cash. The balance of both classes of shares was offered to the public and fully subscribed, and the amounts due, 5*s.* per share on Application, and 5*s.* on Allotment, were paid. The assets and liabilities taken over (at agreed values) from the old company were as follows: Freehold Works, £15,000; Plant and Machinery, £6,000; Stock, £4,000; Sundry Debtors, £12,000; Patents, £4,000; Sundry Creditors, £1,000. Give the Journal entries necessary to record the above transactions in the books of the Company, open its Ledger and show its initial Balance Sheet. (*Royal Society Arts.*)

31. The following Balance Sheet was issue by the Eldorado Plantations, Ltd.:—

BALANCE SHEET, DECEMBER 31, 19...

Dr.	£	£	Cr.		£
Issued Share Capital	190,000		Leasehold Land, Buildings, and Machinery at cost		200,000
Less Calls in arrear	8,000	182,000	Railway, Wharf, Motor Boats, Live Stock, etc., at cost	£12,000	
Bank Loan		48,000	*Less* Depreciation	500	11,500
Sundry Creditors		3,647	Expenditure on 19... Crop to date.		48,400
Bills Payable		32,100	Expenditure on 19... Crop to date.		685
Profit and Loss Account—			Advances to Coolies and Sundry Debtors		6,850
Profit for the year	9,120		Exchange Suspense Account		392
Less Interim Dividend paid	9,100	20	Cash on Plantation		1,850
Depreciation Fund		5,000	Cash at Bankers in London		1,090
		£270,767			£270,767

You are asked to criticise this Balance Sheet from the point of view of a prospective shareholder. If you desire any further information before giving your opinion, submit the letter which you would address to the secretary of the company. (*Chartered Institute Secretaries.*)

32. The directors of a limited company issued the understated account to their shareholders. Do you approve of this document? If not, what amendments do you suggest?

BALANCE SHEET, DECEMBER 31.

Dr.	£	Cr.	£
To Share Capital	500,000	By Land, Buildings, Plant, Stock, Furniture, and Goodwill	1,007,000
,, Reserve Fund	100,000	,, Debtors, Cash, Investments, and Sundry Debtor Balances	166,000
,, Sinking Fund for Leases	10,000		
,, Mortgages and other outstanding Liabilities	535,000		
,, Balance carried down	28,000		
	£1,173,000		£1,173,000
	£		£
To Interim Dividend paid	25,000	By Balance brought down	28,000
,, Balance carried forward	3,000		
	£28,000		£28,000

(*London Chamber Commerce.*)

33. At a recent examination, the understated Balance Sheet was sent in by a candidate. Have you any criticism to offer upon it?

BALANCE SHEET, DECEMBER 31.

Messrs. A & B

Dr. Cr.

Assets.		£	Liabilities.		£
Plant Account		4,000	A.'s Capital	£3,000	
Debtors	£8,200		*Add* Interest	150	3,15
Less Provision (31/12/19...)	410	7,790	B.'s Capital	£2,000	
A.'s Drawings		300	*Add* Interest	100	2,10
B.'s Drawings		200	Creditors		9,80
Repairs		120	A.'s Profits		1,80
Stock (Jan. 1)	£3,200		B.'s Profits		1,50
Stock (Dec. 31)	4,000	7,200	Depreciation on Plant		20
Cash		420	Provision for Debtors (Jan. 1)		35
			Balance		83
		£20,030			£20,03

34. Criticise the Balance Sheet set out hereunder. If you do not approve o it, amend it.

Blanks, Ltd.

BALANCE SHEET FOR YEAR ENDING DECEMBER 31, 19...

Dr. Cr.

		£		£
Ordinary Share Capital	£86,000		Stock on hand	32,00
Less Forfeited Shares	400	85,600	Uncompleted Contracts	165,99
Preference Share Capital		100,000	Cash	2,21
Depreciation Fund		2,500	Goodwill and Trade Marks	56,00
Debentures—1,000 Debentures of £100 each, at 5%, issued at 90		90,000	Plant and Machinery	24,60
Bank Overdraft and Sundry Creditors		15,562	Sundry Debtors	10,20
Profit for the year	£12,850		Unpaid Calls	1,50
Balance from last year	2,250			
	15,100			
Less Preference Dividend and proposed Ordinary Dividend	13,560	1,540		
		£295,502		£295,5

(Chartered Accountants.)

35. Report fully in what respect the following Balance Sheet is not in accor dance with the Companies Act, 1948, or established practice. Illustrate b re-drafting same in proper form.

BALANCE SHEET OF F.A.Q. CO., LTD., AS ON APRIL 1, 19...

Dr. Cr.

		£			£
To Stock-in-Trade		8,412	By Loan on Mortgage of Co.'s Property		20,0
,, Book Debts		16,201	,, Trade Liabilities		16,4
,, Buildings		41,120	,, Capital: £120,000 in Shares of £1 each, all issued, 10s. paid up	£60,000	
,, Plant and Machinery		79,480	*Less* 8,000 Shares cancelled, 10s. paid	4,000	56,0
,, Profit and Loss Account	£8,975		,, Reserve Fund		14,5
Less Shares cancelled	4,000	4,975	,, Debentures issued		40,0
,, Cost of Issue of Debentures		641	,, Bills payable		8,4
,, Bills receivable not yet due		4,500			
		£155,332			£155,3

I have examined the above Balance Sheet and find same correct.

X.Y.Z., *Auditor.*

36. The following items have been extracted from the debit sides of various Balance Sheets: Marine and Fire Insurance Reserve; Dilapidations Reserve; Rebate on Bills not due (Bank); Forged Transfer Fund.

Give your interpretation of these items, and briefly state how they have been created in the books of the various companies. *Royal Society Arts.*

37. The following items appear on the assets side of the Balance Sheet of a limited company:—

			£
(a)	Discount and Expenses on Debentures issued during the year		8,500
(b)	Patents at Cost (granted seven years ago)		6,840
(c)	Leasehold Property at Cost	£10,000	
	Additions during the year	2,000	
			12,000

Lease expires 5 years hence.

If, in your opinion, any provision is necessary in order to reduce the book values of the above items, describe the principle upon which such provision should be based. *Royal Society Arts.*

38. The books of Tanner, Blacker & Co., Ltd., leather manufacturers and merchants, show the following balances on December 31:—

Share Capital Authorised and Issued: 100,000 7% Preference Shares of £1 each, £100,000; 200,000 Ordinary Shares of £1 each, £200,000. Freehold Land and Buildings, £216,000; Rent of Leasehold Premises, £500; Stores and Material on hand, January 1, £30,000; Repairs of Buildings, £400; Rates, £2,780; Insurance Premiums, £350; Freight Charges Outwards, £700; Office Furniture, £250; Purchases, £60,000; Sales, £180,000; Balance at Bank, £4,500; Cash in hand, £500; Bills Receivable, £6,000; Bills Payable, £3,000; Wages, £16,000; Plant and Machinery at written down cost on January 1, £115,000; Repairs to Machinery, £4,000; Salaries, £2,500; Sundry Trade Expenses, £1,620; Sundry Office Expenses, £750; Debtors, as per Sales Ledger, £6,000; Creditors, as per Purchases Ledger, £8,000; Directors' Fees, £1,000; Audit and Accountancy Charges, £150; Credit to Profit and Loss Account on January 1, £8,000.

At December 31, survey of the Stock shows its value at £50,000, and Work in Progress value £15,000.

Payments in Advance amount to £150 on account of Insurance, and £150 on account of Rates.

Provide £4,000 on account of Income Tax, £300 on account of accrued Wages, £5,000 for Contingencies Reserve, and £500 Provision for Bad Debts.

Depreciate Freehold Premises at the rate of 2% per annum, and Plant and Machinery at the rate of 10% per annum.

Prepare Trial Balance, and after making the necessary adjustments, prepare a Trading Account, a Profit and Loss Account, and a Balance Sheet. *Incorporated Accountants.*

(*Note.*—Students should also work some of the long Exercises which appear at the end of Chapter XII.

CHAPTER VI

PARTNERSHIP

I. LEGAL

Note.—All references to sections, etc., in this chapter are to the *Partnership Act*, 1890, unless otherwise stated.

THE Law of Partnership is one of the branches of the law that has been consolidated and codified, and is therefore easy of reference. The three governing Acts are :—

(1) *The Partnership Act*, 1890.—This is the Statute which codified and consolidated the law of partnership as it had been established by a long course of commercial usage and judicial decisions.

(2) *The Limited Partnership Act*, 1907.—This Act makes it possible to limit the liability of a partner, so that a partnership may comprise one or more general partners, exercising the ordinary powers, and subject to the ordinary liabilities of partners, and one or more partners with limited powers and limited liability ; but no partnership may consist solely of limited partners (*see* p. 137).

(3) *The Registration of Business Names Act*, 1916.—This Act, one of the war-time measures, compels registration of the true names of all the members of a partnership when the firm name of the partnership does not consist of those names (*see* p. 121).

It should be clearly understood, at the outset, that the relationship between partners may be whatever the partners mutually agree between themselves that it shall be, and that such agreement may be evidenced by writing, or be inferred as a fact from the course of conduct pursued by the partners. It is only in the absence of any agreement, express or implied, between partners, modifying or abrogating the provisions of the *Partnership Act*, 1890, that that Act regulates the partnership relation of the partners *inter se*.

Definition of Partnership.—"Partnership is the relation which subsists between persons carrying on business in common with a view of profit" (S. 1). Another definition suggested by Sir Frederick Pollock in his *Digest of the Law of Partnership* (11th edition, p. 4) is "Partnership is the relation which subsists between persons who have agreed to share the profits of a business carried on by all or any of them on behalf of all of them."

The Act declares (S. 2) that the relation between members of any company or association which is registered under the Companies Acts ; or incorporated by any other Act of Parliament, or letters patent, or Royal Charter ; or a company engaged in working mines within and subject to the jurisdiction of the Stannaries, is *not* a partnership.

The existence of a business is essential to the idea of partnership and the term "business" includes every trade, occupation, or profession. The association of a number of persons for the purpose of forming a club, or a friendly society, or for charitable purposes, does not constitute those persons a partnership. Nor does the joint ownership of property by itself involve partnership. Two men may own a house and divide the net income derived therefrom without being partners. A may own a theatre and pay the general expenses of the theatre, B may provide and pay the acting company, and A and B share the gross receipts, without being partners (S. 2). But the use of the joint property for profit to be divided between the owners may create a partnership. If the joint owners of a house furnish it and let lodgings, and divide the profits, they are carrying on a business in partnership.

What Creates Partnership.—It is often important to ascertain whether a partnership exists, either to determine the rights of the parties between themselves, or (more often) that creditors may know by whom payment of their debts is to be made. Compulsory registration of partnerships, in cases where the firm name does not disclose the true names of the partners, has made the task easier; but since the partners may have failed to register, the tests of the existence of the partnership relation are still important.

The receipt by a person of a share of the profits of a business is *prima-facie* evidence that he is a partner in the business (S. 2 (3)). But this *prima-facie* evidence may be capable of rebuttal.

Where losses are shared as well as profits the presumption is stronger, but even that is not conclusive. If the agreement is in writing, the fact of partnership and the intention of the parties are to be deduced from the whole document. "The question is whether there was a joint business or whether the parties were intending to carry on the partnership as agents for each other" (*Hawksley* v. *Outram*, [1892], see also *Cox* v. *Hickman*, [1860]).

The Act expressly declares that certain things shall not of themselves create a partnership:—

By S. 2, ss. (1) and (2), joint tenancy, tenancy in common [two methods of holding real property], joint property, common property, or part ownership [words appropriate to and covering both realty and personalty] does not of itself create a partnership as to anything so held or owned, whether the tenants or owners do or do not share any profits made by the use thereof. Nor does the sharing of gross returns, whether or not the persons sharing have a joint interest in the property from which the returns are made.

By S. 2 (3), the receipt by a person of a share of the profits of a business, or of a payment contingent on or varying with the profits of a business, does not of itself make him a partner in the business; and in particular:

(*a*) The receipt by a person of a debt or other liquidated amount by instalments or otherwise out of the accruing profits of a business, does not of itself make that person a partner in the business.

(*b*) A contract for the remuneration of a servant or agent of a person engaged in business by a share of the profits of the business does not of itself make the servant or agent a partner in the business (*c*) The receipt by the widow or child of a deceased partner by way of annuity of a portion of the profits made in the business, does not of itself make the widow or child a partner in the business.

(*d*) A loan to a person or to partners engaged or about to engage in any business on a contract that the lender shall receive a rate of interest varying with the profits, or a share of the profits, does not of itself make the lender a partner in the business, *provided* that the contract is in writing and signed by or on behalf of all the parties thereto.

(*e*) The receipt by a person by way of annuity or otherwise of a portion of the profits of a business in consideration of the sale by him of the goodwill of the business, does not of itself make the recipient a partner in the business.

But the lender in (*d*) and the vendor in (*e*), if the borrower or the purchaser becomes a bankrupt, or enters into an arrangement with his creditors to pay them less than 20s. in the £, or dies insolvent, cannot recover anything for his loan or sale of the goodwill until all other persons who are creditors at the date of the insolvency are paid in full (S. 3). A pretended repayment and fresh advance will not evade the statute. But a genuine repayment and advance on different terms may enable the lender to rank *pari passu* with the other creditors.

Firm Name.—Persons who have entered into partnership are called collectively a "firm," and the name under which the business is carried on is the "firm name." A man may in England call himself by any name he chooses, and a firm may take any name it likes, provided no fraud is intended thereby. There is not property in a firm name as there is in a trade mark, but the Courts will prevent a name being assumed, or used, in such a way as to induce the public to believe that they are dealing with persons already known by the same name. So the partners carrying on the business of Day & Martin, blacking manufacturers, who had acquired their rights from the original producers, although no partner remained bearing either of those names, obtained an injunction against a Mr. Day and a Mr. Martin, who also traded as blacking manufacturers. But there must be intent to deceive before the Court will grant an injunction.

Registration of Business Names.—There was formerly no registration of firms, and it was often difficult to ascertain who were the partners. Under the *Registration of Business Names Act*, 1916, there must be registration of any firm name which does not consist of the true surnames of all the partners, without any addition, except the Christian names (or first or forename) or the initials, or recognised abbreviations of these names.* The registration must disclose the business name, the nature of the business, the principal place of business, and in respect of each partner his present Christian name and surname, and any former Christian name and surname, his nationality, and his nationality of origin if that is different, his usual residence, and other business occupation, if any. The date of the commencement of the business must be stated if it began after December 22, 1916.

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* The Act applies also to an individual carrying on business in a name other than his own.

Not only must the partners' names and nationality, if not British, be registered, but these particulars must be stated in all trade catalogues, circulars, showcards, and business letters. Curiously enough, invoices are omitted from this list of documents.

The penalty for not registering is a fine not exceeding £5 per day while the default continues. But there is a further consequence, the extreme severity of which marks the war-time origin of the Statute. A firm in default cannot enforce any contract by process of law. No debt due to a firm that ought to be registered, but is unregistered, can be recovered. The Courts have power to grant relief where non-registration is accidental, or inadvertent; or where circumstances make it just and equitable to grant relief; and, in fact, relief is generally granted subject to terms as to costs.

The firm name is merely a short way of referring to the partners collectively. A firm is not in England a separate entity, *i.e.* a legal person. Scots law differs in this respect.

Partnership Must be Legal.—No partnership to carry on the business of banking may have more than ten partners, nor any other business more than twenty.* And the objects of the partnership must be legal. The allegation of a partnership between highwaymen in an action for accounts was visited with serious consequences, not only to the parties, but also to solicitor and counsel who appeared for the plaintiff. A partnership for selling smuggled goods is illegal, or for bookmaking contrary to the *Betting Act*, or secret pawnbroking. A solicitor cannot enter into partnership with a person not a solicitor: partnership cannot exist between barristers.

Infant as Partner.—A partner must be capable of contracting. An infant is not bound by a partnership contract, and may repudiate, or adopt, the contract on his coming of age, but he cannot recover any premium paid if he has derived real benefit from the contract. Where a firm with an infant partner is insolvent, a receiving order cannot be made against the whole firm, but may be made against the firm other than the infant partner.

The Partnership Agreement.—A partnership agreement need not necessarily be in writing. A written contract is extremely desirable; but (unless the partnership is for a period of more than one year, in which case, by the provision of the *Statute of Frauds*, the agreement must be in writing) an oral agreement is valid. Written agreements are sometimes under seal, sometimes under hand only. An unsigned draft agreement, if acted upon by the partners, or an informal memorandum, initialled by the partners, and intended as instructions for a formal document, may be evidence of the terms of partnership. The original agreement, even if in writing, may be varied by oral agreement, and a mode of dealing in which all the partners have acquiesced is evidence of such a variation. With respect to a partnership agreement, it is to be observed, that all parties being competent to act as they may agree amongst themselves, they may, by mutual consent, put an end to it or vary it at any moment. The terms of such variations may be evidenced in writing, or solely by the conduct of the parties, and their mode of conducting the business (*England* v. *Curling*, [1844]).

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* *Companies Act*, 1948, SS. 429 and 434.

But although it has been held that usage, uniform and without variation, not strictly in accordance with the Articles of Partnership, is evidence of a new agreement by the partners, and is as binding as if it had been originally clearly prescribed by the Articles, yet where Articles of Partnership provided that the share of a deceased partner in the assets should be ascertained by reference to the annual account made up to the 30th of April next after his death, and there had not been any case of death during the continuance of the partnership, it was held that there could be no practice or usage uniform and without variation, since the case had never arisen: and further that the assets should be taken at their fair value at the date of the account, and not at their value appearing in the books of the partnership (*Cruikshank* v. *Sutherland*, [1922]).

Contents of Partnership Agreement.—A partnership agreement or deed (for it may be under hand or under seal), if it is to deal with all the matters to be regulated, cannot well be short. Brevity is generally achieved only at the cost of incompleteness, though where the terms provided by the *Partnership Act* are such as the parties desire, it is possible to shorten the document to some extent. But Lord Lindley has pointed out that such omissions are not to be recommended. It is desirable that the partnership agreement shall be, as far as possible, a complete code to which the partners may refer, should need arise. A partnership agreement usually deals with the following matters:—

(*a*) The firm name, the business to be carried on under that name, and the address or addresses at which the business is to be transacted.

(*b*) The commencement and duration of the partnership.

(*c*) Power for a partner to retire after notice given, if that is agreed.

(*d*) The capital of the partnership fixed or otherwise, and the shares in which the partners are to be entitled to it. Interest on capital.

(*e*) Provisions for bringing in further capital, and for loans by partners to the firm. Interest on loans.

(*f*) The proportion in which profits and losses are to be divided between the partners.

(*g*) Partnership salaries, if any. In the absence of agreement no salary is payable.

(*h*) The drawings of the partners. Interest on drawings.

(*i*) The bankers of the partnership. All moneys received to be paid into the bank. Powers of partners to sign cheques, accept bills, etc.

(*j*) The payment of rent and other necessary outgoings.

(*k*) The duties of the partners, such as requiring them to be just and faithful to the others, to render accounts, and to devote their whole time to the conduct of the business, or such time as may be agreed.

(*l*) Such restrictions as preclude a partner from being concerned in any other business, or engaging or dismissing clerks without the consent of the other partners, or pledging the credit of the firm except in the ordinary course of business, or giving credit to forbidden persons, or entering into contracts in excess of a stipulated sum without the consent of the other partners.

(*m*) Further restrictions preventing a partner from becoming bail, or surety, or security for persons outside the partnership, or assigning or charging his share in the partnership business, or releasing debts due to the firm, and a stipulation that each partner shall pay his own private debts, and indemnify the firm's property against private claims made upon him.

(*n*) The keeping of proper books of account. Books always to be available for inspection by any partner. The periodical taking of accounts. Arrangements for audit, if any.

(*o*) The creation of a reserve fund.

(*p*) Provision that the death or retirement of one partner shall not dissolve the partnership as regards the remaining partners.

(*q*) The winding-up of the business on the determination of the partnership, with or without special stipulation as to the value of the goodwill. It is usual to have a clause enabling surviving or continuing partners to purchase the share of a deceased or retiring partner, and, frequently, to pay the purchase money by instalments with or without giving security for the unpaid balance. Interest is usually payable on the outstanding balance. Joint assurance policies on the partners' lives are sometimes taken out in order to provide the necessary funds for this purpose.

(*r*) Provisions as to basis on which the goodwill and other assets of the business are to be valued on the death or retirement of a partner.

(*s*) Power for a partner to bring a son into the firm.

(*t*) Power in the event of gross breaches of duty by one partner for the other partners to expel him from the firm, and to enable them to sign any document necessary for effecting the expulsion.

(*u*) An arbitration clause. This is more valuable in the case of a partnership than in many other cases where arbitration is resorted to. Questions arising between partners, often involving the taking of accounts, are better determined in the quiet and privacy of the arbitration room than they are in Court.

Numerous variations in these clauses may be made to meet special circumstances and needs.

Relations of Partners to Persons Dealing with Them.—It is the characteristic feature of partnership law that a partner is both a principal and an agent: a principal binding himself by his acts done on behalf of the firm, and an agent by the same acts binding his partners. Every act of a partner, carrying out in the usual way business of the kind transacted by the firm, binds the partners, unless, in fact, the partner had no authority to act for the firm in the particular matter, *and* the person with whom he deals either knows that he has no authority or does not know or believe him to be a partner (S. 5).

Whatever private arrangements partners have between themselves, the persons dealing with them are entitled to assume that in matters within the scope of the partnership business each partner is authorised to bind the firm. In a trading partnership,* therefore, every partner may bind the firm by selling the firm's goods, buying goods on account of the firm, receiving payment of debts due to the firm, engaging servants for the partnership business, accepting bills, borrowing money on the firm's credit, pledging the firm's goods, or creating an equitable mortgage by deposit of deeds. On the other hand, one partner cannot bind the other partners by deed without express authority, nor can he bind the firm by giving a guarantee in the name of the firm, even if it is a reasonable and convenient thing to do in the circumstances, unless it is the custom of the firm, or the general custom of firms engaged in the same business, so to do.

If the firm is a non-trading firm there is no implied authority to borrow. Architects, *e.g.* do not usually borrow money, so that there is no implied power for an architect to bind his firm by borrowing. Nor is there implied power for partners of a non-trading partnership to accept bills, or pledge chattels † on behalf of the firm. At least the onus is on a claimant to prove that giving bills or pledging chattels is usual or necessary in the business.

Where there is what is called a *dormant* or *sleeping partner*, usually a partner who contributes capital to the firm, and receives a share of the profits, but who takes no active part in the management of the business, and does not hold himself out as being a partner, or disclose his name in the firm name, the presumed agency of the active partners is probably rebutted. But it is more difficult now than it was formerly for such a state of things to arise, in view of the need for registration.

When a partner exceeds his authority, the other partners may adopt the transaction. If they do so they are bound by it. They may be bound, also, if they have notice of the transaction and do not repudiate it. A mere complaint to the partner exceeding his authority, not followed by any other step, would probably be held insufficient repudiation, and the firm would be bound.

Where money borrowed by *one partner*, in the name of the firm, without the authority of his co-partners, has been applied in paying off debts of the firm, the lender is entitled to repayment by the firm of the amount which he can show to have been so applied. And the same rule extends to money *bona fide* borrowed and applied for any other legitimate purpose of the firm (*Lindley on Partnership*).

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* A trading business is one which involves the purchase and sale of goods. But not every business which involves the expenditure of money for goods which the business requires is a trading business. A partnership for the purpose of running a cinema is not a trading business (*Higgins* v. *Beauchamp*, [1914]).

† *Chattels.*—Goods movable, *e.g.* oxen, furniture, jewellery, etc. (*chattels personal*) and goods immovable, *e.g.* an interest in land, other than a freehold interest (*chattels real*), which belong immediately to the person of the owner are termed *chattels*, as opposed to *choses in action*, e.g. debts, bonds, etc., of which a man has not the actual possession, but to which he has rights enforceable at law.

Where a partner pledges the credit of the firm for a purpose apparently not connected with the firm's ordinary course of business, the firm is not bound, unless he is in fact specially authorised by his partners: but this does not affect any personal liability incurred by an individual partner (S. 7).

Questions arise sometimes when a partner raises money by giving negotiable securities in the firm name for the purpose of satisfying his private debt, or pays his private debt out of partnership funds. The person lending money in such a case must be prepared to show that the partner had in fact authority to act as he did, or that the other partners had so acted as to give reasonable ground for supposing that such authority had been given, in which case the firm may be bound by estoppel.*

If the partners agree that a restriction shall be placed on the authority of one or more partners to bind the firm, nothing done in contravention of the agreement is binding on the firm with respect to persons having notice of the agreement (S. 8). But, of course, the restriction does not affect persons having no such notice.

Liability of Partners.—Every partner in a firm is liable jointly with the other partners, and in Scotland severally [= separately] also, for all debts and obligations of the firm incurred while he is a partner; and after his death his estate is also severally liable in a due course of administration for such debts and obligations, so far as they remain unsatisfied, but subject in England to the prior payment of his separate debts (S. 9).

Where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the firm, or with the authority of his co-partners, loss or injury is caused to any person not being a partner in the firm, or any penalty is incurred, the firm is liable therefor to the same extent as the partner so acting or omitting to act (S. 10).

The firm is liable to make good a loss:—

(*a*) where one partner, acting within the scope of his apparent authority, receives the money or property of a third person and misapplies it; and

(*b*) where a firm in the course of its business receives money or property of a third person, and the money or property so received is misapplied by one or more of the partners, while it is in the custody of the firm (S. 11).

The liability under S. 9 is joint; under SS. 10 and 11 it is joint and several.

If judgment is recovered against the firm on a joint liability, each partner is liable for the whole amount of the judgment. But if the plaintiff sues individual members of the firm, and recovers judgment, he cannot afterwards sue other partners, even if he did not know that they were partners when he recovered judgment (*Kendall* v. *Hamilton*, [1879]). The defendant in such an action may apply to the Court to order that the other joint debtors be added as defendants. Since the estate of a deceased partner is severally liable, the fact that judgment has been obtained against the firm does not prevent the creditor suing the personal representatives.

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* *Estoppel.*—If one person, A, either by his words or his conduct induces another person, B, to believe in a state of facts and act upon that belief, then A may be *estopped*, *i.e.* precluded from setting up the real facts, and the rights as between A and B may be regulated not by the state of the facts as they actually are, but by the state of the facts as A represented them to be.

Where the liability is joint and several, the fact that judgment has been obtained against one partner does not prevent the creditor suing the other partners.

Enforcing a Judgment Against a Firm.—Where a creditor of a partnership has secured judgment against a firm he may issue execution against any property of the partnership. He may also issue execution against the goods of an individual partner who was personally served with the writ as a partner, and has not entered an appearance, or who has appeared in his own name as a partner, or has admitted on the pleadings that he is a partner. If the plaintiff seeks to issue execution against a person who has not been so served, or who has not appeared as a partner, or admitted that he is one, he must apply to the Court for leave. If the fact of partnership is then denied, the Court will first hear and decide the issue whether the respondent is a partner.

Liability for Wrongs.—It is essential in order to establish liability to show that the wrongful act was done in the ordinary course of the partnership business. For example:—

> A and B are solicitors practising in partnership. C, a client of the firm, entrusts money to A to be invested in a specific security. A mis-appropriates the money. B knows nothing of the transaction. B is liable since it is part of the ordinary business of solicitors to invest in specified securities (*Blair* v. *Bromley*, [1847]). But in a case similar except that C gave to A only general instructions to invest the money as A thought fit, B is not liable for A's mis-appropriation of the money, since it is not the ordinary business of solicitors to receive money to be invested at their discretion (*Harman* v. *Johnson*, [1853]).

The question is whether the wrongdoer was acting as agent for the firm and within the apparent scope of his agency.

If a partner, being a trustee, improperly employs trust-property in the business or on account of the partnership, no other partner is liable for the trust-property to the persons beneficially interested therein, unless he has had notice of the breach of trust; but if the money is still in the firm's possession or under its control, the beneficiaries may follow and recover it (S. 13).

Holding Out.—A person may become liable as a partner without actually being one, if he "holds himself out" to be a partner. If he represents himself to be one, or knowingly allows himself to be so represented, and on the faith of such representation credit is given to the firm, he is liable to the creditor. He is estopped from denying the character which he has assumed, and on the faith of which the creditor acted (S. 14 (1)). A man who has retired from a firm, but has given no notice of dissolution of partnership, and allows his name still to be used as part of the firm name may be liable on this ground. But the continued use of a deceased partner's name as part of the firm name does not of itself impose any liability on the deceased partner's estate for partnership debts contracted by the firm after his death (S. 14 (2)).

Incoming and Outgoing Partners.—A person admitted as a partner into an existing firm does not thereby become liable to creditors of the firm for anything done before he became a partner. A retiring partner does not cease to be liable for debts incurred before his retirement (S. 17). An agreement by continuing partners to indemnify a retiring partner is usual; and if the creditor by express agreement, or agreement to be implied from the course of his dealing with the new firm, consents to look to the new firm for payment, then the retiring partner is discharged from liability. There is then a novation of contract, *i.e.* the creditor has expressedly or impliedly accepted the new firm as his debtors instead of the old. Thus:—

> A and B were bankers in partnership. C and D were admitted as new partners, and notice was given to all creditors. A died, and subsequently B died. C and D continued to carry on the business, but became insolvent. Depositors who knew of A's death, but had continued afterwards to receive interest on their deposits, and had proved as creditors in the bankruptcy of C and D, cannot afterwards sue A's estate (*Bilborough* v. *Holman*, [1876]).

A mere agreement between the old partners and incoming partners that the new firm shall discharge the old firm's debts does not give to the old firm's creditors a right to sue the new firm. There must be an agreement between the firm as newly constituted and the creditor before action by him will lie against the new firm. Creditors cannot enforce a contract to which they are not parties.

A continuing guarantee given either to a firm or to a third person in respect of the transactions of a firm, is revoked as to future transactions by any change in the constitution of the firm, unless the contrary is agreed (S. 18).

Relationship of Partners to One Another.—The mutual rights and duties of partners, whether stated in a partnership agreement or defined by the Act, may be varied by the consent of all the partners, and such consent may be given expressly, or be inferred from a course of dealing (S. 19). So where articles of partnership provided for a valuation of partnership property, to be made on the annual account day, for the purpose of settling partnership profits, and a valuation was for many years made and acted on by all the partners, it was not open to a partner or his personal representative to challenge the accepted mode of valuation, even though inconsistent with the terms of the articles (*Coventry* v. *Barclay*, [1864]).

All property originally brought into the partnership stock, or acquired by purchase or otherwise on account of the firm, or for the purposes and in the course of the partnership business, is partnership property, and must be held by the partners exclusively for the purpose of the partnership in accordance with the partnership agreement; and, unless a contrary intention appears, property bought with money belonging to the firm is deemed to have been bought on account of the firm (SS. 20, 21). So, when a firm bought land and the conveyance was taken in the name of one partner, the land was partnership property. Where one partner bought shares in his own name and without the authority of the other partners, but with the money and on account of the firm, the shares were partnership property. A partner renewing the lease of partnership offices in his own name holds the lease in trust for the firm.

Where any land, or any heritable interest therein has become partnership property, it shall, unless the contrary intention appears, be treated as personal or moveable estate, not real estate (S. 22). Land acquired for partnership purposes was usually conveyed to the partners as tenants in common; but, by S. 24 of the *Law of Property Act*, 1925, an undivided share of land is not now capable of being created, and where land is conveyed to persons in undivided shares the conveyance takes effect as if conveyed to them as joint tenants upon "the statutory trusts." These trusts are to sell the property (but with power to postpone the sale) and to stand possessed of the net proceeds of sale so as to give effect to the rights of the persons interested in the land. Freehold or leasehold property belonging to the partnership will, therefore, be held in future upon trust for sale; but no sale will be made until the persons holding the majority of the interests desire a sale, and presumably their right to require a sale will be controlled by the terms of the partnership agreement. Obviously a sale of the premises where the partnership business is carried on might ruin the business.

Rights and Duties of Partners *inter se*.—The Act contains important rules declaring the rights and duties of the partners. By S. 24 the interests of partners in the partnership property and their rights and duties in relation to the partnership shall be determined, *subject to any agreement expressed or implied between the partners*, by the following rules:—

(1) All the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses whether of capital or otherwise sustained by the firm.*

(2) The firm must indemnify every partner in respect of payments made and personal liabilities incurred by him—

(*a*) in the ordinary and proper conduct of the business of the firm; or

(*b*) in or about anything necessarily done for the preservation of the business or property of the firm [such as money found to pay a pressing debt].

(3) A partner making, for the purpose of the partnership, any actual payment or advance beyond the amount of capital which he has agreed to subscribe, is entitled to interest at the rate of 5% per annum from the date of the payment or advance.

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* The skill of a partner may be of value to the firm out of all proportion to the capital he brings in. Where the partners have not apportioned profits the Court will not do so. "Equality is equity, not as being absolutely just, but because it cannot be known that any particular degree of inequality is more just" (Pollock, *Digest of the Law of Partnership*, p. 83).

(4) A partner is not entitled, before the ascertainment of profits, to interest on the capital subscribed by him.

(5) Every partner may take part in the management of the partnership business. [By agreement the management may be delegated to one or more partners, and such an agreement is binding.]

(6) No partner shall be entitled to remuneration for acting in the partnership business. [But compensation may be received by one partner for extra trouble occasioned by another's neglect of business.]

(7) No person may be introduced as a partner without the consent of all existing partners. [This is a fundamental principle of partnership law. Partnership is based on the personal confidence of partners in one another. The introduction of a stranger is contrary to the basis of a partnership. A partner may indeed assign his share, and this (unlike a charging order on a share under S. 23) does not necessarily give a right to the other partners to dissolve the partnership; but the Court might consider that such an assignment makes it just and equitable to order a dissolution.]

(8) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners, but no change may be made in the nature of the partnership business without the consent of all existing partners. [Any such decision must be made in good faith for the benefit of the partnership as a whole, and every partner must have an opportunity of being heard.]

(9) The partnership books are to be kept at the place of business of the partnership (or the principal place, if there is more than one), and every partner may, when he thinks fit, have access to and inspect and copy any of them. A partner may employ an agent for this purpose, provided that the other partners have no reasonable ground of objection to the particular agent selected, but the agent may not use the information derived from inspection for any other purpose than to advise his principal. [But the partner making such extracts has, after he has ceased to be a partner, no right to make use of them for purposes injurious to the firm.]

These rules, it will be noticed, are "subject to any agreement expressed or implied between the partners." They apply only so far as they are not contrary to any provisions on these points contained in the partnership agreement.

Partners are bound to render true accounts and full information of all things affecting the partnership to any partner or his legal personal representatives (S. 28). Partnership is a contract *uberrimæ fidei* [of the utmost good faith]. Between partners this is obviously essential.

Every partner must account to the firm for any benefit derived by him without the consent of the other partners from any transaction concerning the partnership, or from any use by him of the partnership property, name, or business connection (S. 29). It is because of this rule that any partner obtaining a renewal of the lease of partnership property in his own name is bound, if the other partners claim it, to treat this as held on behalf of the firm, and the rule would probably be the same even if the partner renewing had told the other partners that he intended to apply for a renewal for his own benefit. On the other hand, if the lease is not renewable, and one partner purchases the property subject to the lease, he is entitled to hold it for his own benefit.

If a partner carries on a competing business without the consent of his partners, he must account to the firm for all profits made in that business (S. 30). If a partner in one firm carries on such a business with the other partner's consent, he must not use information obtained from the partnership for the benefit of the other business or to the prejudice of the firm.

Determination and Expiration of Partnership.—Where no fixed term has been agreed on for the duration of the partnership any partner may determine the partnership at any time on giving notice of his intention so to do to all the other partners (S. 26).

Where a partnership entered into for a fixed term is continued after that term has expired, and without any express new agreement, the rights and duties of the partners remain the same as they were at the expiration of the term, so far as is consistent with a partnership at will [*i.e.* one which continues so long as all the partners are willing]. It can therefore be terminated at any time. A continuance of the business by the partners, or such of them as habitually acted therein during the term, without any settlement or liquidation of the partnership affairs, is presumed to be a continuance of the partnership (S. 27). The terms of the old agreement continue to apply as far as practicable, *e.g.* an arbitration clause contained in an agreement for a fixed term still applies when the partnership is continued after the end of the term. But a clause providing for a notice of a certain length in order to terminate the partnership before the end of the specified term is not applicable.

A partnership deed usually contains powers for the majority of the partners to expel the remaining partner or partners; but unless such a power is expressly given there is no power of expulsion. Where such power exists it must be exercised in good faith and in strict compliance with the terms of the document. The conditions of good faith include reasonable preliminary warning and opportunity of explanation, and the fact that partners are expressly relieved from the duty of stating their reasons does not dispense them from the duty of acting in good faith.

Assignment of and Charges on a Partner's Share.—A partner cannot assign his share so as to make his assignee a partner, or introduce a new partner into the firm without the other partners' consent. If a partner assign his share, *e.g.* by way of mortgage to secure a debt due from him, the assignee acquires no right to interfere in the management of the partnership business, or to inspect the books, or to require an account. The assignee is entitled only to receive the share of the profits to which the assigning partner would otherwise be entitled, and he must accept the account of profits agreed to by the partners. Upon a dissolution of the partnership, the assignee is entitled to the assigning partner's actual share of the partnership assets. He is not bound by any agreement between the partners for valuing the share, and is entitled to have an account taken as from the date of the dissolution in order to ascertain the true value of the share (S. 31).

Partnership Property and Partner's Separate Judgment Debt.—It is not possible to enforce a judgment obtained against an individual partner by issuing execution against partnership property. The judgment creditor can now enforce the judgment in respect of the partnership property only by obtaining an order charging the partner's interest in the partnership property and profits, for the judgment debt and interest thereon; and the Court may appoint a receiver of the partner's share (S. 23). This was an alteration effected by the Partnership Act: for at common law partnership property might be taken in execution for the separate debt of any partner, and the debtor's interest therein could be sold. The person obtaining such a charging order has no right to take part in the business nor does the order as a rule entitle a judgment creditor to have accounts rendered to him by the other partners.

The Court may order a sale of the debtor partner's interest. In that event the other partners may purchase it, and at any time they may redeem the interest charged. Or they may obtain an order for dissolution of the partnership.

Section 23, which regulates procedures against partnership property for a partner's separate judgment debt, does not apply to Scotland.

Dissolution of Partnership.—A partnership may be dissolved at any time by mutual consent of the partners.

In addition, subject to any agreement between the partners, a partnership may be dissolved, under S. 32, by:—

(*a*) Expiration of the term fixed for the partnership.

(*b*) If entered into for a single adventure or undertaking, by the termination of that adventure or undertaking.

(*c*) If entered into for an undefined time, by any partner giving notice to the other or others. [Such notice once given cannot be withdrawn without the consent of all the partners.]

Further, by S. 33, a partnership is dissolved by:—

(*d*) The death of a partner. [This dissolves the partnership as regards all the partners unless the contrary has been agreed.]

(*e*) The bankruptcy of any partner. [This also dissolves the partnership as regards all the partners unless the contrary has been agreed.]

(*f*) When a partner suffers his share of the partnership property to be charged under the Act for his separate debt, the partnership may at the option of the other partners be dissolved.

Again, by S. 34, a partnership is in every case dissolved:—

(*g*) By the happening of any event which makes it unlawful for the business of the firm to be carried on or for the members of the firm to carry it on in partnership. [*E.g.* partnership with an alien enemy. The outbreak of war in 1914 dissolved many partnerships. The term "alien enemy" includes persons of every nationality residing in an enemy country.]

Lastly, by S. 35, partnerships may be dissolved by the Court. On application by a partner, the Court may decree a dissolution:—

(*h*) When a partner is found lunatic, or is shown to the satisfaction of the Court to be of permanently unsound mind. Proceedings may be taken by the Committee of the lunatic or next friend or person having title to intervene, or by any other partner.

(*i*) When a partner becomes in any other way permanently incapable of performing his part of the partnership contract.

(*j*) When a partner has been guilty of such conduct as, regard being had to the nature of the business, is calculated prejudicially to affect the carrying on of the business.

(*k*) When a partner wilfully or consistently commits a breach of the partnership agreement, or otherwise so conducts himself in matters relating to the partnership business that it is not reasonably practicable for the co-partners to continue in partnership with him. [The degree of misconduct sufficient to induce the Court to dissolve a partnership is difficult to determine. Refusal to meet the partners in matters of business and continual quarrelling have been held sufficient, so also has a state of hostility which has become chronic and renders mutual confidence impossible; but not mere squabbles and ill-temper. The Court will, if such a state exists, make an order on the application of either party, but under (*i*), (*j*), and (*k*) above will not act at the instance of the partner who is to blame.]

(*l*) When the business of the partnership can only be carried on at a loss.

(*m*) When it is just and equitable that the partnership should be dissolved. [It is said that the marriage of a female partner (which formerly dissolved a partnership) might make it just and equitable to order a dissolution.)

Rescission of a Partnership Agreement.—Where a person is induced by fraud or misrepresentation to become a partner, the Court will rescind the contract at his instance. In such a case a partner seeking rescission is entitled to be indemnified against the liabilities which he has incurred owing to his becoming a partner. The extent of the indemnity is stated in the Act (S. 41). Without prejudice to any other right he is entitled:—

(*a*) To a lien, or right of retention of, the surplus assets, after satisfying partnership liabilities, for any sum paid by him for the purchase of his share in the partnership, and for any capital contributed by him.

(*b*) To stand in the place of the creditors of the firm for any payments made by him in respect of the partnership liabilities.

(*c*) To be indemnified by the person guilty of the fraud or misrepresentation against all the debts and liabilities of the firm. He is also entitled to recover damages from the person guilty of the fraud, and, where the Act gives him a lien for principal moneys mentioned in S. 41 (*a*) above, to interest on those moneys, and costs of the action. He is also entitled to interest on all payments made by him in respect of partnership liabilities.

Dissolution by an Arbitrator.—Where there is an arbitration clause referring all disputes to arbitration and a dispute arises involving the question whether the partnership has been or ought to be dissolved, the arbitrator has power to dissolve the partnership.

Consequences of Dissolution.—As a general rule a partner is not liable for the acts of his former partners after the dissolution of the firm or his retirement from it; but to protect himself against third persons an advertisement of the dissolution should be inserted in the *London Gazette*, and as regards persons who have already had dealings with the firm a specific notice of dissolution must be given.

A and B, partners, execute a deed declaring the partnership dissolved as from January 1. They do not discontinue the business or give notice of dissolution. On February 1 A indorses a bill in the partnership name to C, who is not aware of the dissolution. The firm is liable on the bill (*ex parte Robinson*, [1833]).

The practice of the *London Gazette* is to require that notices of dissolution shall be signed by all the partners or their legal representatives, and the signatures be verified by the statutory declaration of a solicitor. A notice not signed by all the partners must be verified by the statutory declaration of a solicitor stating that such notice is given pursuant to the terms of the partnership to which it refers.

If a partner has, notwithstanding dissolution, given his partners authority to act for him, he will be bound by anything done by them within the limits of such authority. In the absence of such an agreement, each partner has authority to bind the firm so far as necessary to wind up the affairs of the partnership, and to complete transactions begun but unfinished at the time of the dissolution, but not otherwise (S. 38); but the firm is in no case bound by the acts of a partner who has become bankrupt.

A bill was indorsed in the name of a firm to a creditor. Before the bill became due the partnership was dissolved. Notice of dishonour given to the continuing partner, but not to the retiring partner, was *held* to be binding on the retiring partner (*Goldfarb* v. *Bartlett*, [1920]).

Money belonging to a trust estate was deposited with a bank, the receipt stating that it was to be paid to the firm of solicitors acting for the trust. The firm was dissolved. One of the partners indorsed the receipt and received, but did not pay over, the money. The beneficiaries under the trust sued the Bank. *Held* that as the receipt of the money was necessary, either to "wind up the affairs of the partnership" or "to complete a transaction begun but not finished before the date of the dissolution," under S. 38, the Bank was justified in paying to the partner (*Dickson* v. *National Bank of Scotland*, [1917]).

The rule as to good faith being essential as between partners applies to transactions undertaken after the partnership has been dissolved by the death of a partner, and before the affairs have been completely wound up. The continuing partners will, if profits are derived from carrying on the business for the purpose of winding up, in the absence of any special reason to the contrary, be entitled to some compensation for their services.

Where a premium has been paid for admission to the partnership there may, in the event of dissolution, be a claim by that partner to a return of the premium (S. 40). Where the partnership is at will, the partner paying the premium must be taken to have run the risk of the partnership being determined at any time, but if the partnership is for a fixed term and is dissolved before the end of the term, otherwise than by the death of the partner, the Court may in its discretion order the repayment of the premium or part of it. The rule usually adopted is to order a return of so much of the premium as bears the same proportion to the whole as the unexpired portion of the agreed term bears to the whole agreed term. A return will not be ordered where the misconduct of the partner paying the premium is the cause of dissolution. Where the partnership has been dissolved by an agreement not providing for a return of part of the premium, no order for the return will be made.

Conduct of the Winding Up.—The partners are the proper persons to get in the assets and wind up the affairs of the partnership, and their power to bind the firm continues for this purpose notwithstanding dissolution (S. 38). If after dissolution they cannot agree as to the winding up, the Court will appoint a receiver and, if necessary, a manager, and will on due occasion restrain a partner by injunction from doing any act which will impede the winding up, such as injuring the value of or misapplying the assets of the firm. Where a partnership has been dissolved by the death or bankruptcy of one of the partners, the continuing or solvent partners are entitled to wind up the affairs, and to an injunction restraining the executors or trustees in bankruptcy from interfering with them.

The Court will on proper grounds, at the instance of executors or trustees, protect the partnership assets and ensure the proper conduct of the winding up.

Application of the Partnership Property—Goodwill.—On dissolution every partner is entitled to have the partnership property applied in payment of the firm's debts and liabilities, and to have any surplus applied in payment of what may be due to the partners (S. 39).

This may involve the sale of the goodwill, which is a commercial rather than a legal expression. It has been described as " the benefit arising from connection and reputation," and as " the probability that the old customers will resort to the old place." The value is obviously greater in a business than a profession. A customer is likely to go to the same shop to buy the goods he has been accustomed to buy, whereas, in the case of a doctor or solicitor, the patient or client goes to his adviser because of his confidence in his skill. The relation is obviously less likely to be continued with the purchaser of the practice. Indeed, it has been said that in the business of solicitors goodwill in the ordinary sense hardly exists.

But whether the value be great or small, every partner has the right to have the goodwill sold, and the proceeds applied as part of the business assets. If this takes place, the purchaser alone may represent himself as continuing or succeeding to the business of the vendors. But any vendor, *i.e.* any partner, may carry on a similar competing business and advertise it, though he may not use the name of the old firm, or represent himself as continuing the old business, or canvass former customers of the old business. The purchaser may use the name of the old firm, but not so as to expose the partners to any liability; he must not represent any vendor as being still in the business.

Until the partnership affairs are wound up, the former partners must not carry on business in the firm name. After the winding up is complete every partner is free to use the firm name (unless the contrary has been agreed), but again not so as to expose a former partner to liability.

Where, after dissolution, the business of the partnership is carried on, without the capital of the outgoing partner being paid to him, and without any final settlement of accounts, then the outgoing partner, or his estate in the event of death, is entitled either to such a share of the profits made since the dissolution as is attributable to his capital, or to interest at 5% on the amount of his share of the capital assets (S. 42). This clause does not apply where the partnership agreement gives to the continuing or surviving partner an option to purchase the share, and the option is exercised.

The amount due from surviving or continuing partners to an outgoing partner, or to his estate, is a debt. In the event of bankruptcy following dissolution the joint creditors whose debts existed at the dissolution must be paid first. But, subject to that rule, the status is changed, and the former partner has become a creditor.

When the assets have been got in they are, by S. 44, to be applied as follows:—

"In settling accounts between the partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed:—

(*a*) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits.*

(*b*) The assets of the firm, including the sums, if any, contributed by the partners to make up losses or deficiencies of capital, shall be applied in the following manner and order:—

(1) In paying the debts and liabilities of the firm to persons who are not partners therein.
(2) In paying to each partner rateably what is due from the firm to him for advances as distinguished from capital.
(3) In paying to each partner rateably what is due from the firm to him in respect of capital.
(4) The ultimate residue, if any, shall be divided among the partners in the proportion in which profits are divisible."

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* See p. 212 as to the difficulties arising owing to the decision in *Garner* v. *Murray*.

In making out accounts on dissolution, it is usual to commence at the date of the last account settled by the partners. It has to be remembered that a practice recognised by the partners in taking accounts may apply only to accounts taken during the continuance of the partnership, and not to a dissolution account.

Administration of the Estate of Deceased Partner.—The surviving partners are creditors of the estate of a deceased partner for what may be found to be due to them on taking the partnership accounts. They may sue the legal representative of the deceased partner for a judgment for a partnership account and payment of what is due, and, if assets are not admitted, for administration of the estate of the deceased. Creditors of the partnership may also claim administration of the estate by the Court. But creditors of the firm are not entitled to be paid out of a deceased partner's estate until all his separate creditors have been satisfied. The rules in bankruptcy, that the debts of the firm are to be paid out of the assets of the firm, and the separate debts of each partner out of the separate estate, and that a partner may not prove against the separate estate of his co-partner while the joint debts are unpaid, have been adopted in administering the estate of a deceased partner.

Limited Partnerships.—Since 1907, partnerships of a special kind have been possible under the provisions of the *Limited Partnerships Act*, 1907. The object of the Act was, apparently, to legalise in this country special partnership arrangements corresponding to those existing in various foreign countries. The change in the law would probably have proved more popular if it had not happened to coincide with the *Companies Act*, 1907, under which private limited companies having only two shareholders were first allowed to be constituted.* But many limited partnerships have been registered under the terms of the Act.

Notwithstanding the provisions of the *Partnership Act*, 1890, a person lending money on the terms of taking a share of profits in a business was considered to run some risk of being held to be a partner. The *Limited Partnerships Act* is designed to avoid this danger. There may under that Act be a limited partnership, consisting of not more than ten partners in the case of a bank, or more than twenty in the case of any other business. One partner at least must be a general partner having the ordinary powers and liabilities of a partner, and one at least must be a limited partner. The partnership must be registered with the Registrar of Joint Stock Companies, together with particulars as to the general nature of the business, the firm name, the principal place of business, the names of the partners, the date of commencement and the term of the partnership, and the amount contributed by the limited partner, or each limited partner, if there be more than one, must be stated. Any changes that occur after registration must also be registered.

The general conduct of the business must be in the hands of the general partner or partners exclusively. The limited partner may inspect the books, examine into the state and prospects of the business, and advise the other partners thereon, but he must not take any part in the management of the business. He cannot bind the firm, nor may he withdraw any part of his capital. So long as he complies with these provisions, a limited partner is liable only to the extent of the capital subscribed by him. If he withdraws any part of his capital, he is liable, to the extent of the amount so withdrawn, for the firm's debts and obligations. If he takes part in the management of the business he becomes a general partner and liable as such for all debts and obligations incurred during the period in which he takes part in the management. The death or bankruptcy of a limited partner does not dissolve the firm; his capital vests in his personal representative, or trustee in bankruptcy. The general partner, or partners, alone decide questions arising in the ordinary course of business, and they may admit new partners without the consent of the limited partner. On the other hand, the limited partner may assign his share (but only with the consent of the general partners), and his assignee becomes a limited partner in his place. The limited partner cannot dissolve the firm by notice. The effect of the Act is that a limited partner may safely invest money in a business and become entitled to a share of profits without any risk of being held to be a partner, and as such liable for the debts of the firm beyond the amount of his capital. The machinery of management is perhaps less cumbrous than in the case of a private company, but the latter device is generally preferred.

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* See *Companies Act*, 1948, S. 1 [1] for authorisation now in force.

EXAMINATION QUESTIONS.

1. Give the definition of partnership as set out in S. 1 of the *Partnership Act*, 1890, and state what relations are expressly declared in that section not to be partnerships. Two executors carried on their testator's business, being so authorised by the will, under the same name as that in which he had carried it on. A receiving order was made against them in the firm name. State, giving reasons, whether or not you think the executors were liable to be adjudicated bankrupt as partners. (*Incorporated Accountants.*)

2. State in what particular features an ordinary partnership differs from a private company, and the latter from a public company. (*Chartered Accountants.*)

3. State whether a partnership exists in the following cases, giving your reasons: (*a*) Smith and Brown are joint owners of a landed estate, which they lease to tenants. (*b*) A lends B £500 for the purposes of B's business, in consideration of a share in the profits by way of interest. (*c*) White and Green were partners in a grocery business. On White's death, his widow agrees to leave his share of capital in the business in consideration of an annuity.

4. Under what circumstances may a share of the profits of a business be paid to a person without constituting that person a partner? (*Chartered Accountants.*)

5. Briefly explain the extent to which a commercial firm may be bound by the acts of the members of the partnership. Enumerate a few financial transactions in the carrying out of which a partner has the implied authority to bind his co-partners. (*Chartered Accountants.*)

6. In respect of what matters, and how, may the ordinary authority and liability of a partner be modified or restricted as regards persons having dealings with the firm?

A, B, and C are partners in trade. C obtains for his sole benefit a renewal of the lease of the premises in which the partnership business is carried on. What are the rights of A and B in respect of the renewed lease?

Give reasons. (*Incorporated Accountants.*)

7. A. M. Khan & Co. issue a notice that they will not be bound by the acts of Lewis, who is one of the partners. Consider the effect of this notice as between the firm and persons dealing with it.

8. Does the advance of money to a person engaged in business, by way of loan, at interest varying with the profits, make the lender a partner, and what is the lender's position if the borrower becomes insolvent? In what way has the *Bankruptcy and Deeds of Arrangement Act*, 1914, affected the law upon either of these points? (*Incorporated Accountants.*)

9. Summarise the acts by which a partner may bind his firm, and state to what extent, if at all, the partnership is liable for the torts of one of the partners. (*Incorporated Accountants.*)

10. "A partner, like a trustee, must not make a private gain by reason of his partnership in the firm." Illustrate this statement. On what general principle of law does it rest? (*Incorporated Accountants.*)

11. How may a new partner be admitted into a firm? (*Royal Society Arts.*)

12. What is the extent of the interest of a partner in the property of the firm? (*Royal Society Arts.*)

13. What powers has a partner of (*a*) engaging and (*b*) dismissing employees? (*Royal Society Arts.*)

14. What is the test, and the extent, of the general liability of partners for the debts of the firm, and how may it be limited in the case of (*a*) incoming partners and (*b*) retiring partners? (*Royal Society Arts.*)

15. What are the rights and duties of partners, as amongst themselves, with reference to signing cheques, rendering accounts, assigning a share of the partnership, carrying on another business, expelling a member of the partnership? (*Incorporated Accountants.*)

16. A and B, who, together with C, are carrying on business as agents for the sale of motor-cars and accessories, have discovered that C made a secret profit when selling a car in the name of the firm. Advise A and B as to their rights. (*Incorporated Accountants.*)

17. Explain the difference, if any, between the rights of partners in a trading concern to borrow money for business purposes as compared with the borrowing powers of the directors of a limited liability company. (*Chartered Accountants.*)

18. It is an implied term of every partnership agreement that each partner must observe the utmost good faith and fairness towards his fellow partners. Explain and illustrate this statement, and set out the provisions of the *Partnership Act*, 1890, which appear to you to be framed with the object of enforcing such implied terms. (*Incorporated Accountants.*)

19. A and B are partners. How far is A liable to C in respect of contracts made with C by B, or of torts committed against C by B? (*Royal Society Arts.*)

20. What is meant by the term "holding out" in relation to a partnership? How far is a person who holds himself out as a partner liable: (*a*) for the debts owing by the firm; (*b*) for money misappropriated by a member of the firm? (*Incorporated Accountants.*)

21. What do you understand by the term "novation" as applied to partnerships? Explain fully what is necessary to constitute "novation." (*Chartered Accountants.*)

22. What is a partnership at will? How may such a partnership, and other partnerships, be determined? (*Incorporated Accountants.*)

23. Define goodwill, and say how it is to be dealt with on a dissolution of a firm. To what extent is the assignor of the goodwill bound not to enter into competition with the successors to the old firm? (*Incorporated Accountants.*)

24. What are the respective liabilities of (*a*) a partner, (*b*) a limited partner, (*c*) a dormant partner, (*d*) a retired partner for the debts incurred by the firm? (*Incorporated Accountants.*)

25. What obligations are imposed on firms by the *Registration of Business Names Act*, 1916? Does the law generally impose any restrictions as regards the name under which a firm may carry on business?

26. What authority is charged with carrying out the provisions of the *Registration of Business Names Act*, 1916, and how is it to deal with: (*a*) misleading business names; (*b*) the removal of names from the register; (*c*) an alteration to be made in the particulars as to any firm, or person, registered under the Act? (*Incorporated Accountants.*)

27. Define a "firm" under the *Registration of Business Names Act*, 1916, and state in what manner registration thereof is to be effected, and what particulars are to be furnished for registration. (*Incorporated Accountants.*)

28. What are the rights of the partners in a trading concern: (*a*) as to borrowing money for the purposes of the business; (*b*) as to interest upon capital? (*Chartered Accountants.*)

29. What effect have the following upon the constitution of the firm: (*a*) death of a partner; (*b*) bankruptcy of a partner; (*c*) assignment by a partner of his share?

30. What ought to be done to protect the interests of all parties (including creditors): (*a*) when a new partner is admitted? (*b*) when the firm is dissolved? Can anyone be held to be a partner in law without intending to be one? (*Chartered Institute Secretaries.*)

31. In what circumstances is a partnership dissolved: (*a*) without having recourse to the Court; (*b*) by judicial proceedings? (*Incorporated Accountants.*)

32. State the various grounds on which the Court will decree the dissolution of a partnership. What becomes of the goodwill of the firm on such dissolution? (*Incorporated Accountants.*)

33. In settling the accounts between the partners after a dissolution of the partnership, what course must be adopted in distributing the assets of the firm? (*Chartered Accountants.*)

34. Following upon a dissolution, how are the assets of a partnership to be applied, and what are included in such assets? (*Incorporated Accountants.*)

35. You are to be appointed auditor under a partnership deed. The Draft Articles of Partnership are sent to you for your opinion and approval of clauses affecting the accounts. What matters of account would you expect to be mentioned in the draft Articles, and state shortly the objects of the clauses? (*Chartered Accountants.*)

36. Mention four clauses which you would expect to find in a deed of partnership, and state in each case the effect, if the deed is silent on that particular matter. (*Chartered Accountants.*)

37. A, B, and C were partners. C retired, and took no steps to free himself from partnership liabilties. His capital on retirement was £10,000. He received half in cash, and left the other half as a loan at a minimum rate of interest of 5%, a higher rate on a sliding scale to be paid dependent on profits. The firm failed. The creditors whose claims existed when C retired amounted to £10,000, and there are claims subsequently contracted of £5,000. Do you consider C is liable for either or both classes of creditors? Give reasons for your answer. (*Chartered Accountants.*)

38. Smith and Jones are proposing to enter into partnership as manufacturers. Smith is to provide £10,000 as capital, and Jones £2,500. Jones is to manage the business and to devote the whole of his time to it. Smith is to devote to the business only so much of his time as he thinks fit.

You are requested to suggest such provisions, for inclusion in the partnership deed, with reference to the accounts and financial matters of the firm as, under the circumstances, you consider fair and right in the interests of both partners. (*Chartered Accountants.*)

39. Specify some of the circumstances which would enable the Court to decree the dissolution of a partnership upon the ground that it is "just and equitable."

o what remedies is the defrauded partner entitled when he has been led into a artnership by misrepresentations? (*Incorporated Accountants.*)

40. How far can a partner's share and interest in a partnership be transferred: a) where he is a general partner; (*b*) where he is a limited partner? What is the ransferee's position with regard to: (*a*) the other partners; (*b*) the creditors of he firm? (*Incorporated Accountants.*)

41. Upon the sale of a partnership business as a going concern the partners btained a substantial sum for goodwill. What is the nature of the money so btained, and how should it be dealt with when finally settling matters as between he partners?

42. In what ways may a partnership be dissolved, *otherwise than by* a decree f the Court? How must the assets be distributed upon a dissolution? (*Char-ered Secretaries.*)

43. Mention briefly the distinctions (if any) between a sleeping partner and a mited partner.

44. What are the rights, if any, of a limited partner of access to, and investigaion of, the accounts of the partnership and of management of the partnership usiness? (*Chartered Accountants.*)

45. In the relations of partners to one another what is their duty as to: a) rendering accounts; (*b*) accounting for private profits; (*c*) competing with heir own firm? (*Incorporated Accountants.*)

CHAPTER VII

PARTNERSHIP

II. PARTNERSHIP ACCOUNTS

THE first thing to do when dealing with partnership accounts is to consider carefully the financial clauses of the partnership agreement. As we have seen, a properly prepared agreement will deal with (*a*) the period, yearly or half-yearly, which the accounts are to cover (*b*) partners' capital; (*c*) partners' salaries, drawings, and interest or capital and drawings; (*d*) the proportion in which profits and losses are to be divided; (*e*) the basis of settlement on the death or retirement of a partner, or the dissolution of the firm; (*f*) goodwill, if any and its treatment; (*g*) financial restrictions that may be imposed upon all or any of the partners.

If there is no partnership agreement, or if the agreement is silen upon any of the above matters, then the *Partnership Act*, 1890, wil apply. Under that Act, as already stated, partners are:—

(i) not entitled to make undisclosed profits out of the firm' business;

(ii) they must share profits and losses equally;

(iii) they are entitled to 5% per annum interest on loans; but

(iv) they are not entitled to interest on capital or to a partnership salary.

There are no statutory books, nor is any system of book-keepin imposed in connection with partnership. The books suitable for sole trader engaged in a similar business are equally suitable for partnership. But, in partnership, certain accounts to record th financial relations of the partners as between themselves are imperativ The dates upon which accounts are to be made up, and the form i which they are to be prepared, are matters of mutual agreement betwee the partners. No creditor or other person has any statutory right t inspect the accounts of a partnership unless by consent of the partner nor have any accounts or returns to be filed with any Governme department.* But partnerships, like sole traders, are liable to g into difficulties in agreeing their liability to Income Tax unless the produce proper accounts to the Inspector of Taxes.

Capital and Current Accounts.—In the majority of cases the capit of a firm is contributed by more than one partner, and this fact mu be recognised in the partnership books. The combined capitals of the partners in a firm correspond to the single capital of a sole trad in that both capitals express and represent the excess of the assets the business over its external liabilities. The proportion in whi capital is contributed in no way affects the proportion in which profits and losses are shared, unless there be an agreement to the contrary.

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* Except that limited partnerships must be registered, and the regulations the *Business Names Act* fulfilled, as explained in the previous chapter.

If the provisions of the *Partnership Act*, 1890, are construed literally, capital contributed by partners is a *fixed* amount, and can be varied only by agreement; and, because losses automatically reduce the capital contributed, they should, in theory, be made good. In practice, however, losses are allowed to stand to the debit of the current account until they are wiped out by subsequent profits, or they are transferred to the debit of the capital account, as may be agreed. This procedure is, in effect, an adjustment of the original contributions of capital made when the accounts for a particular financial period have been prepared and agreed.

Students are sometimes perplexed by S. 24 of the *Partnership Act*, which states: "All the partners are entitled to share equally in the capital and profits of the business. . . ." This does *not* imply that if, for example, A and B are partners and contribute £10,000 and £1,000 respectively as capital, B is entitled to a half-share of A's capital, or, upon a dissolution, to half the assets of the partnership. The meaning is that, in the absence of an agreement to the contrary, profits or losses of capital are to be shared equally between A and B.

A separate capital account is opened for each partner, and this account is credited with the particular partner's capital contribution. For book-keeping purposes, the credit balances of these capital accounts are treated as a liability of the firm.

Drawings.—The majority of partnership agreements authorise the partners to withdraw from the business definite yearly sums in periodical instalments. These cash withdrawals are termed *drawings*. They are not withdrawals of capital, but are partial anticipations of the share of current profits to which each partner will become entitled when the firm's annual accounts have been prepared. During the currency of a financial year, drawings are treated as a debt due to the firm,* and are debited as described below. Normally, they are regarded as payments on account of profits accruing. But should a loss be made instead of a profit, or should the drawings exceed the profit made, then in the first case the whole of the sums drawn, and in the second the excess of the drawings, becomes a debt due to the firm, which, in theory, should be made good in order to preserve the capital intact. In practice, however, debits in respect of drawings are usually carried forward, for the time being at any rate, by mutual agreement between the partners.

There are two methods of recording capital and drawings in the partnership books.

First method.—Each partner is credited in his Capital Account with the amount of capital he has paid in, and also, at the close of the year, or other agreed accounting period, with: (*a*) interest on capital at the agreed rate which, usually, is 5% per annum; (*b*) his share of profits, if any; and (*c*) his partnership salary, if any. The Capital Account is debited with: (i) all sums withdrawn by the partner as and when they occur, together with interest thereon at the agreed rate, which again is usually 5% per annum; (ii) the partner's share of the loss, if any; and (iii) any goods of the firm which the partner may have withdrawn for his personal use during the period. Under this treatment the identity of the partner's original contribution of capital is soon lost.

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* See *Elliott* v. *Elliott* on p. 216.

H. Dickson.

CAPITAL ACCOUNT.

Dr.

Date.	Particulars.	Folio.	Days.	Interest.			Drawings, etc.		
				£	s.	d.	£	s.	d.
19...									
April 1	To Cash	4	275	7	10	8	200	0	0
July 1	" Cash	36	184	2	10	5	100	0	0
Sept. 1	" Cash	72	122	3	6	10	200	0	0
Dec. 31	" Interest	J. 41		13	7	11	13	7	11
" 31	" Balance carried down	√					5,986	12	1
							£6,500	0	0

G. McArthur.

CAPITAL ACCOUNT.

Dr.

Date.	Particulars.	Folio.	Days.	Interest.			Drawings, etc.		
				£	s.	d.	£	s.	d.
19...									
Mar. 1	To Cash	2	306	8	7	8	200	0	0
Oct. 1	" Cash	79	92	3	15	7	300	0	0
Dec. 31	" Interest	J. 41		12	3	3	12	3	3
" 31	" Goods Account .	S.L. 14					17	6	8
" 31	" Balance carried down	√					2,345	10	1
							£2,875	0	0

Illustration.—H. Dickson and G. McArthur are trading in partnership as Dickson, McArthur & Co. From the details given below prepare the Capital Accounts of the partners as on December 31, 19...

H. Dickson, balance of Capital Account, January 1, 19..., £5,000.

G. McArthur, balance of Capital Account, January 1, 19..., £2,000.

H. Dickson, drawings: April 1, £200; July 1, £100; September 1, £200.

G. McArthur, drawings: March 1, £200; October 1, £300. Goods withdrawn to December 31, £17 6s. 8d.

Profits are divisible: two-thirds to H. Dickson and one-third to G. McArthur.

Interest at 5% is allowed on capital and charged on drawings. G. McArthur is entitled to a partnership salary of £150 per annum. The final net profit after adjustment for the Interest as above for the year was £1,875. [For solution, *see* pp. 144–145.]

Second method.—The more modern practice is to open two separate accounts for each partner, a Capital Account and a Current Account.

H. Dickson.

CAPITAL ACCOUNT—*continued.*

Cr.

Date.	Particulars.	Folio.	Amount.		
			£	s.	d.
19... Jan. 1	By Balance brought forward	P.L. 21	5,000	0	0
Dec. 31	„ Interest on Capital	J. 42	250	0	0
„ 31	„ Share of Profits for the year	P.L. 31	1,250	0	0
			£6,500	0	0
19... Jan. 1	By Balance brought down	√	5,986	12	1

G. McArthur.

CAPITAL ACCOUNT—*continued.*

Cr.

Date.	Particulars.	Folio.	Amount.		
			£	s.	d.
19... Jan. 1	By Balance brought forward	P.L. 27	2,000	0	0
Dec. 31	„ Interest on Capital	J. 42	100	0	0
„ 31	„ Share of Profits for the year	P.L. 31	625	0	0
„ 31	„ Partnership Salary	J. 28	150	0	0
			£2,875	0	0
19... Dec. 31	By Balance brought down	√	2,345	10	1

By this method, each partner's capital is, in conformity with the *Partnership Act*, assumed to be a *fixed amount*, variable only as may be mutually agreed, as indeed actually is the case in many partnerships. In addition to the obvious advantage of keeping the Capital Account free from cumbersome detail, this practice is supported by several legal decisions, and is superseding the older method outlined above. The student will therefore be wise, when dealing with examination questions on partnership accounts, to adopt this modern method, unless it is clear from the opening position that the alternative method has been adopted in the past.

By the modern method, the Capital Account is confined to the amount of capital brought forward from the last financial period, adjusted as may be necessary to record capital sums subsequently brought in or withdrawn by mutual agreement. The Current (Draw-

H. Dickson.

CAPITAL ACCOUNT.

DR.

£	s.	d.

H. Dickson.

CURRENT ACCOUNT.

DR.

Date.		Particulars.	Folio.	Days.	Interest.			Drawings, etc.		
					£	s.	d.	£	s.	d.
19...										
April	1	To Cash	4	275	7	10	8	200	0	0
July	1	,, Cash	36	184	2	10	5	100	0	0
Sept.	1	,, Cash	72	122	3	6	10	200	0	0
			J.							
Dec.	31	,, Interest	41		13	7	11	13	7	11
,,	31	,, Balance carried down						980	12	1
								£1,500	0	0

G. McArthur.

CAPITAL ACCOUNT.

DR.

£	s.	d.

G. McArthur.

CURRENT ACCOUNT.

DR.

Date.		Particulars.	Folio.	Days	Interest.			Drawings, etc.		
					£	s.	d.	£	s.	d.
19...										
Mar.	1	To Cash	2	306	8	7	8	200	0	0
Oct.	1	,, Cash	79	92	3	15	7	300	0	0
			J.							
Dec.	31	,, Interest	41		12	3	3	12	3	3
			S.L.							
,,	31	,, Goods Account .	14					17	6	8
,,	31	,, Balance carried down	✓					345	10	1
								£875	0	0

H. Dickson.

CAPITAL ACCOUNT—*continued*.

CR.

		P.L.	£	s.	d.
19...					
Dec. 31	By Balance brought forward	21	5,000	0	0

H. Dickson.

CURRENT ACCOUNT—*continued*.

CR.

Date.	Particulars.	Folio.	Amount.		
19...		J.	£	s.	d.
Dec. 31	By Interest on Capital	42	250	0	0
„ 31	„ Share of Profits for the year		1,250	0	0
			£1,500	0	0
19...					
Dec. 31	By Balance brought down	√	986	12	1

G. McArthur.

CAPITAL ACCOUNT—*continued*.

CR.

		P.L.	£	s.	d.
19...					
Dec. 31	By Balance brought forward	27	2,000	0	0

G. McArthur.

CURRENT ACCOUNT—*continued*.

CR.

Date.	Particulars.	Folio.	Amount.		
19...		J.	£	s.	d.
Dec. 31	By Interest on Capital	42	100	0	0
„ 31	„ Share of Profits for the year	P.L. 31	625	0	0
„ 31	„ Partnership Salary	J. 28	150	0	0
			£875	0	0
19...					
Dec. 31	By Balance brought down	√	345	10	1

ings) Account is debited and credited with the same items mentioned in the first method. Interest on any loan made by a partner to the firm is also credited to the partner's Current Account.

Where a partner withdraws *goods* from the business, a personal account should be opened in the partner's name in the Sales Ledger to record the transaction, and the balance of this personal account should be transferred to the debit of the partner's account at the close of the financial period, and should not be included amongst sundry debtors. Usually, such drawings in kind are charged out to a partner at or slightly above cost price.

The credit balance of a partner's Current Account represents undrawn income from the business, and although a partner is not strictly entitled to interest on a credit balance unless the partnership agreement provides for interest, yet usually interest is allowed at an agreed rate upon a credit balance until it is withdrawn, otherwise a partner whose Current Account was in credit would not be treated equitably. If a partner's Current Account shows a debit balance, the balance should appear as a separate item on the assets side of the Balance Sheet as a debt due to the firm. Under some partnership agreements, interest is charged on a debit balance.

Illustration.—Take the particulars given in the example on p. 144 and prepare separate Capital and Current Accounts for H. Dickson and G. McArthur as on December 31, 19... (For solution, see pp. 146–147.)

Partner's Loans.—Where the partnership deed mentions specific amounts as the capital of the partners, then, in the absence of any specific agreement to the contrary, any further sums paid in by partners are of the nature of loans. If no fixed capital has been arranged, it should be made clear in the partnership deed that additional payments in are to be treated as loans carrying interest. When a loan is advanced by a partner to the firm, a separate Loan Account should be opened for the partner, and a note should be made, as part of the heading of the account, stating the rate of interest payable and the terms of repayment, *e.g.* "Rate of Interest 6% per annum. Loan repayable by annual instalments of £250 on the 1st of January in each year." We have already seen that, in the absence of agreement to the contrary, partners are entitled to interest at 5% per annum on sums *advanced* by them to the firm as distinct from capital. But, notwithstanding this statutory right, it is advisable that the partnership agreement should clearly declare the method of treating loans and credit balances on current account, and the interest to be paid thereon. A partner cannot be charged with interest on any sums advanced *to* him by way of loan from the funds of the partnership unless it be so agreed. Under common law, loans do not carry interest, except by agreement or special custom.

In addition to the statutory regulations regarding specific loans, as described above, the student's attention should be directed to S. 24 (3) of the Act, which says: "A partner making, for the purposes of the partnership, any actual payment or advance beyond the amount of capital which he has agreed to subscribe, is entitled to interest at the rate of five per cent. per annum from the date of the payment or advance." Assume, by way of illustration, that A and B are partners. A has proceeded abroad, on the firm's business, and his return has been unexpectedly delayed, the firm's funds run short, and B is obliged to advance, from his private resources, £200 to meet wages and current needs. B is entitled to 5% interest per annum on this £200.

Sleeping (Quasi) Partner.—It has already been stated that by S. 2, ss. (3), (*d*) a person may have "capital" in a business by way of a loan entitling him to receive in lieu of interest an agreed share of the profits without incurring the liabilities of an ordinary partner. Such "partners" take no active participation in the business, and are known as *sleeping* or *quasi* partners, although in effect they are deferred creditors, as such loans are not repayable until all outside liabilities have been satisfied. At the close of the financial period, the profits of the business having been ascertained, the share due to the sleeping partner should be debited in the appropriation section of the Profit and Loss Account in the ordinary way, credited to the Loan Account, and discharged by payment in due course.

Illustration.

GEORGE DICKSON, LOAN ACCOUNT.

ONE-TWELFTH OF PROFITS IN LIEU OF INTEREST.

Dr.											Cr.
19...			£	s.	d.	19...			£	s.	d.
Feb. 5	To Cash	C.B.	465	0	0	Jan. 1	By Transfer from Capital Account	√	6,000	0	0
" 5	" Balance carried down	√	6,000	0	0	Dec. 31	" Share of Profits for the year		465	0	0
			£6,465	0	0				£6,465	0	0
						19...					
						Feb. 5	By Balance brought down	√	6,000	0	0

Interest on Capital.—It has already been explained that interest on capital cannot be charged unless it has been specifically agreed that it should be charged. However, it is the general practice, under the *First Method* explained above, to credit partners with interest at an agreed rate, usually 5% per annum, on their capital, or on the current balance of their capital accounts. This practice appears to confuse some students. But it should be borne in mind that this so-called "interest" is not interest which in the ordinary sense has been earned as such. It is a preliminary appropriation to the credit of the partners of a share of the firm's profits based upon the amount of their respective capitals, and is termed interest for convenience. A little thought will convince the student that an allowance ought to be made for interest in cases where the capital of the firm is contributed in a ratio other than that in which profits and losses are shared. Unless this is done, the rights of the partners *inter se* will not be adjusted equitably. Even in cases where the capital is equally held and profits are shared *pro rata*, it is usual and advisable to allow for interest on capital, in order that the partners may see what profit has been made by the business over and above the income which investment of the capital in outside securities would have produced.

Illustration 1.—The brothers George Dickson (Capital, £10,000) and Hugh Dickson (Capital, £3,000) are equal partners, and devote equal time and energy to the business. If no provision for interest on capital is made, George Dickson will contribute and risk £7,000 more capital than his brother, without any monetary compensation, although he could obtain, say, £350 per annum from outside investment of this sum. If 5% interest on capital is allowed, the rights of the partners will be equitably adjusted.

Illustration 2.—J. McArthur and L. Pirrie are equal partners and have contributed £10,000 each as capital. No provision has been made for interest on capital. The profits of the firm for the year 19... were stated in their Profit and Loss Account at £1,875. The partners could have safely invested their capital to produce, say, £900 per annum. The actual return for the time and work they have contributed and the trading risks they have incurred is therefore not £1,875 but £975. A provision for interest would, of course, make no difference to the ultimate income of the partners, but it would call their attention to the actual return secured by risking their capital in trade, compared with the income they could have obtained from gilt-edged securities, their liability in the latter case being limited to the capital at stake, whereas, as traders, their liability is unlimited.

Illustration 3.—Dickson's capital is £5,000, and Chatenay's capital is £2,500. Profits are shared as to three-fifths to Dickson, and two-fifths to Chatenay. The profit to be divided is £2,000. If no interest on capital is charged, Dickson will get £1,200 and Chatenay £800. If 5% interest is charged, Dickson will get three-fifths of £1,625 + £250 interest = £1,225, and Chatenay will get two-fifths of £1,625 + £125 interest = £775. The discrepancy between the capitals of the two partners will thus be adjusted equitably.

It should be noted that interest on capital ceases from the date of a dissolution of partnership, notwithstanding the time occupied in disposing of the assets or completing the winding-up. In the absence of agreement to the contrary, the same rule applies to partnership salaries.

The interest on capital credited to the partners' accounts is clearly an appropriation of the profits of the firm. In actual practice it is common to make *direct transfers* of the interest allowed from the credit of the respective Current Accounts to the debit of the Interest on Capital Account. Strictly speaking, a Journal Entry should be passed through the books as follows:—

JOURNAL.

				Dr.			Cr.		
			P.L.	£	s.	d.	£	s.	d.
19...									
Dec. 31	Interest on Capital Account	Dr.	71	1,050	0	0			
	To G. McArthur		16				500	0	0
	,, W. F. Dreer		21				350	0	0
	,, B. Uprichard		32				200	0	0
	For interest on capital at 5% per annum for the year ended December 31, 19...								

At the close of each financial period the total balance of the Interest Account is transferred to the debit of Profit and Loss Account (preferably Appropriation Section).

Interest on Drawings.—Where drawings take place of amounts in the same ratio as that in which partners share profits and losses at fixed intervals, no particular advantage is gained by charging interest on the amounts drawn. But the need for the charge is clear where the drawings of the partners are not in this ratio or are irregular in date. Interest runs from the date of the drawing to the close of the financial period, and is usually at the rate of 5% per annum. The common practice is to provide two extra columns on the debit side of the partners' Current Accounts to accommodate (*a*) the number of days, and (*b*) the amount of interest on each drawing, as shown in the current accounts on p. 146. Theoretically, when these debits are made, corresponding entries should be passed to the credit of Interest on Drawings Account. But in practice the debits are collected at the close of the financial period in one journal entry as follows:—

JOURNAL.

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
19... Dec. 31	Sundries :— Dr.	P.L.						
	G. McArthur	27	36	2	4			
	W. F. Dreer	32	21	1	8			
	B. Uprichard	41	12	17	6			
	To Interest on Drawings Account	76				70	1	6
	For interest at 5% per annum on partners' drawings for the year ended December 31, 19...							

Illustration.—Abel Chatenay and Alfred Colomb are partners who have contributed capital equally, and share profits equally. There is no agreement concerning drawings, or for charging interest thereon. During the year 19..., Chatenay's drawings were: July 1, £200; December 1, £200, Colomb's drawings were: March 1, £300; May 1, £200; July 1, £300; October 1, £200; December 1, £400. Chatenay therefore withdrew £400 and Colomb £1,400. It is to be presumed that the difference of £1,000 could have been employed profitably in the business. Certainly it could have been invested safely and earned interest; indeed, Colomb could have invested the £1,000 to his own profit. Unless, therefore, interest is charged on the drawings, Colomb will benefit at the expense of Chatenay.

It should not be necessary to remind students of advanced book-keeping that partners' drawings are in no sense a *charge* against profits They are merely instalments paid on account of profits which are assumed to be accruing to the business. If that assumption proves incorrect, then drawings in excess of the ascertained profits are debts due to the firm. These remarks are here obtruded, because, in the author's experience, some candidates make the serious error of principle of debiting drawings to the Profit and Loss Account when answering examination questions.

In practice, direct entries are usually made, debiting Interest on Capital Account, and crediting the partners' Current Accounts with interest due on capital, and crediting Interest on Drawings Account and debiting Current Accounts with interest on drawings. If Journal entries are made, as from an academic point of view they should be made, they would appear as shown on p. 152.

Partnership Salaries.—It has already been explained that partners are not entitled, as a matter of right, to a partnership salary, no matter what services they may render to the partnership business. But in some partnerships, one (or more) of the partners may devote more time, or greater technical skill and experience, to the business than the other partners. It is usual to recognise this greater devotion or skill by means of a partnership salary, paid or credited to the partner (or partners) concerned. Junior partners frequently receive a fixed salary, and a small share only of the profits. Such salaries are charged against profits prior to division. If partnership salaries are paid in cash at agreed intervals, they may be posted direct from the Cash Book to the debit of Partnership Salaries Account. But, under most agreements, the more usual method is to credit the partners' Current Accounts at the close of the financial period with the salaries due, and to debit Profit and Loss Account with the same amounts. In practice, the transfers are usually made direct, but, theoretically, journal entries should be made. Where a partnership salary is one of the adjustments required by the terms of an examination question, the necessary entry is:—

JOURNAL.

			Dr.			Cr.		
		P.L.	£	s.	d.	£	s.	d.
19... Dec. 31	Interest on Capital Account . . . . Dr.	16	750	0	0			
	To A. Dickson, Current Account	41				500	0	0
	,, B. Morse, Current Account	52				250	0	0
	For interest on capital at 5% for the year ended this day.							
,, 31	Sundries :— Dr.							
	A. Dickson, Current Account	42	56	18	6			
	B. Morse, Current Account	53	21	9	4			
	To Interest on Drawings Account . . .	17				78	7	10
	For interest at 5% on drawings during the year.							
,, 31	B. Morse, Current Account . . . . Dr.	53	31	14	5			
	To B. Morse, Goods Account	S.L. 147				31	14	5
	For balance transferred, being goods supplied during the year.							
,, 31	Interest Account . . . . Dr.	P.L. 16	100	0	0			
	To A. Dickson, Current Account	41				100	0	0
	For interest at 5% for the year on loan of £2,000.							

JOURNAL.

			Dr.			Cr.		
		P.L.	£	s.	d.	£	s.	d.
19... Dec. 31	Profit and Loss Account . . . . . Dr.	87	500	0	0			
	To G. McArthur, Current Account . . .	32				500	0	0
	For partnership salary for the year ended December, 31, 19...							

In the absence of a note as shown above in Journal form, examination candidates usually make the Profit and Loss charge correctly, but are apt to overlook the compensating entry in the current account as set out in the Balance Sheet.

Illustration.—A. Chatenay and T. Testout each contribute £5,000 as capital and share profits equally. Chatenay owns and works a farm, and devotes but three days a week to the partnership business. Testout gives his whole time to the business. It was agreed that, prior to the division of profits, Testout should be credited with £450 per annum as a partnership salary. The profits of the firm, after providing for all charges except Testout's salary, were £3,264. Interest is allowed on capital and charged on drawings at 5% per annum.

Testout's drawings were £968, and the charge for interest thereon was £23 6*s.* 8*d.* On January 1, 19..., the credit balance of Testout's Current Account was £76 10*s.* 5*d.* Prepare the final section of the firm's Profit and Loss Account, and Testout's Current Account as it would appear in the firm's Balance Sheet on December 31, 19...

Chatenay & Testout.

PROFIT AND LOSS ACCOUNT (FINAL SECTION) FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.		£	s.	d.	Cr.	£	s.	d.
To Partnership Salary . . .		450	0	0	By Balance brought down .	3,264	0	0
„ A. Chatenay, Half-share of Profits . .	£1,407							
„ T. Testout, Half-share of Profits . .	1,407							
		2,814	0	0				
		£3,264	0	0		£3,264	0	0

Note.—The Interest on Capital and Drawings should also appear in the Final Section, but the question indicates that these have been adjusted in the earlier section of the Profit and Loss Account.

BALANCE SHEET, DECEMBER 31, 19...
(LIABILITIES SIDE ONLY.)

		£	s.	d.	£	s.	d.
Capital :—							
A. Chatenay		5,000	0	0			
T. Testout		5,000	0	0			
					10,000	0	0
Current Account :—							
T. Testout :							
Balance, December 31, 19...		76	10	5			
Interest on Capital		250	0	0			
Partnership Salary		450	0	0			
Share of Profits		1,407	0	0			
		2,183	10	5			
Less Drawings	£968 0 0						
Interest thereon	23 6 8						
		991	6	8			
					1,192	3	9

If, in the illustration given on p. 152, the capital of the partners was not "fixed" in amount, Testout's Capital Account would be set out in the Balance Sheet as follows:—

BALANCE SHEET.
(LIABILITIES SIDE ONLY.)

		£	s.	d.	£	s.	d.
Capital :—							
T. Testout :							
As per last Balance Sheet		5,076	10	5			
Interest on Capital		250	0	0			
Partnership Salary		450	0	0			
Share of Profits for the year . .		1,407	0	0			
		7,183	10	5			
Less Drawings . .	£968 0 0						
Interest thereon	23 6 8						
		991	6	8			
					6,192	3	9

Losses.—Losses must, of course, be debited in the agreed proportions to the partners' Current Accounts, and the final balances of these accounts, if in debit, must be set out on the Assets side of the firm's Balance Sheet. Unless the partnership articles otherwise stipulate, or further working capital is required, partners, in practice, do not make good a shrinkage in the original capital contributed by them, except, as explained later, in the event of dissolution. It is usual, however, for the Articles to provide that interest at a rate agreed shall be charged on the debit balances of Current Accounts until made good. If this is not done, partners whose Current Accounts remain in credit are not equitably treated.

Examination candidates are advised to prepare a partnership Profit and Loss Account in two sections. The *first* section will show the detailed charges to be met out of the gross profit brought from the Trading Account. The resulting balance, representing the net profit or loss divisible between the partners, will be carried to the *second* section, in which the division of the balance will be shown. By this method, the net result of the year's trading appears clearly as a *separate figure*, and is quickly available when the information is required, or comparisons with former years have to be made. Moreover, this method saves the time of the examiner! The practice frequently adopted by candidates of completing the debit side of the Profit and Loss Account by entries representing the share of profits due to the partners is not, of course, inaccurate, but it is out of harmony with usual business practice, and it compels an examiner to work an addition sum in order to secure the information he seeks!

Sometimes, partnership Profit and Loss Accounts are prepared in *three* sections. Section I shows the actual net trading result; Section II the details of interest on capital and on drawings, partnership salaries, and other similar partnership adjustments; Section III, the division of the resulting balance between the partners. This method facilitates the preparation of Income Tax returns, and shows the trading results at a glance as distinct from mere partnership allocation.

Illustration.—George, Hugh, and Robert Dickson trade as Dickson Brothers. Profits are divided: one-half to George, and one-quarter each to Hugh and Robert. Interest at 5% is allowed on capital and charged on drawings. The capital is fixed, and is held as follows: George, £10,000; Hugh, £5,000; Robert, £3,000. At the close of each year a partnership salary of £300 is to be credited to Hugh, and one of £200 to Robert. The following balances appeared in the Trial Balance of the firm on December 31, 19...: Trading Account (Credit Balance), £14,290; Office Salaries, £2,371; Office Expenses, £214; Reserve for Bad Debts, January 1, 19..., £320; Sundry Debtors, £8,440; Discount Account (Credit Balance), £37; Office Furniture, £740; Machinery and Plant, £3,460; Office Rent, Rates, Heating, Lighting, £942; Loan at 5% per annum from George Dickson, £2,000; Travellers' Salaries and Commission, £3,270; Carriage Outwards, £374; Advertising, £845; Bank Interest and Charges, £159; Bad Debts, £277. Partners' drawings: George, £1,250 interest thereon, £29; Hugh, £572, interest thereon, £19; Robert, £985, interest thereon, £22. Partners' Current Accounts on January 1, 19...: Credit Balances, George, £949; Hugh, £227; Debit Balance, Robert, £319. Robert Dickson, for goods had, debit balance, £79. A provision for bad debts equal to 5% on the Sundry Debtors is to be made. Depreciation is to be provided as follows: Machinery and Plant, 15% per annum; Office Furniture, 5% per annum. The interest at

Dickson Brothers.

DR. PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19... CR.

Dr.		£	s.	d.	Cr.	£	s.	d.
To Depreciation of Machinery and Plant *		519	0	0	By Balance from Trading Account	14,299	0	0
„ Balance carried down, being gross profit		13,780	0	0				
		£14,299	0	0		£14,299	0	0
To Rent, Rates and Heating		942	0	0	By Balance brought down	13,780	0	0
„ Office Salaries		2,371	0	0	„ Discounts (net)	37	0	0
„ Office Expenses		214	0	0				
„ Depreciation (Office Furniture)		37	0	0				
„ Advertising		845	0	0				
„ Travellers' Salaries and Commission		3,270	0	0				
„ Carriage Outwards		374	0	0				
„ Bad Debts written off		277	0	0				
„ Provision for Doubtful Debts:—								
December 31, 19...	£422 0 0							
Less January 1, 19...	320 0 0	102	0	0				
„ Bank Interest and Charges		159	0	0				
„ Balance carried down, being net profit for year		5,226	0	0				
		£13,817	0	0		£13,817	0	0
To Interest on Loan (Geo. Dickson)		100	0	0	By Balance brought down	5,226	0	0
„ Partnership Salaries:—					„ Interest on Drawings	70	0	0
Hugh Dickson	£300 0 0							
Robert Dickson	200 0 0	500	0	0				
„ Interest on Capital:—								
George Dickson	£500 0 0							
Hugh Dickson	250 0 0							
Robert Dickson	150 0 0	900	0	0				
„ Balance carried down, being divisible profit for the year		3,796	0	0				
		£5,296	0	0		£5,296	0	0
To George Dickson, ½ Share of Profits	£1,898 0 0				By Balance brought down	3,796	0	0
„ Hugh Dickson, ¼ Share of Profits	949 0 0							
„ Robert Dickson, ¼ Share of Profits	949 0 0	3,796	0	0				
		£3,796	0	0		£3,796	0	0

* In practice, all depreciations are frequently dealt with in the Profit and Loss Account. Strictly speaking, in a manufacturing business depreciation on Machinery and Loose Tools is a part of the manufacturing cost, and should appear in the Manufacturing Account. In view of the diversity of practice, however, either treatment would probably be equally marked in examination work.

Dickson Brothers.

BALANCE SHEET, DECEMBER, 31, 19...

(PARTNERS' ACCOUNTS ONLY.)

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Capital :—							Current Account :—						
George Dickson . . .	10,000	0	0				*Robert Dickson :*						
Hugh Dickson . . .	5,000	0	0				As on January 1, 19... .	319	0	0			
Robert Dickson . . .	3,000	0	0	18,000	0	0	Drawings . . .	985	0	0			
							Interest thereon . .	22	0	0			
Current Accounts :—							Goods Account . . .	79	0	0			
George Dickson :								£1,405	0	0			
As on January 1, 19... .	949	0	0				*Less* Partnership Salary . £200						
Interest on Loan . .	100	0	0				Interest on Capital . 150						
Interest on Capital . .	500	0	0				Profit for the year . . 949						
Profit for the year . .	1,898	0	0					1,299	0	0	106	0	0
	3,447	0	0										
Less Drawings . £1,250													
Interest thereon 29	1,279	0	0	2,168	0	0							
Hugh Dickson :													
As on January 1, 19... .	227	0	0										
Partnership Salary . .	300	0	0										
Interest on Capital . .	250	0	0										
Profit for the year . .	949	0	0										
	1,726	0	0										
Less Drawings . . £872													
Interest thereon 19	891	0	0	835	0	0							
Loan Account :—													
George Dickson . . .				2,000	0	0							

5% per annum on George Dickson's loan must be provided for. Prepare the firm's Profit and Loss Account for the year ended December 31, 19..., and show the position of the partners as it would appear in the Balance Sheet at the same date.

EXAMINATION QUESTION.

On December 31, 19..., three partners had the following amounts at the credit of their Capital Accounts: A, £5,000; B, £3,000; C, £2,000.

On January 1 previous, they had to the credit of their Drawing Accounts: A, £750; B, £500; C, £400.

Profits are divided in the same proportion as the capital, up to £2,000. Above that amount, A gets 25%, B 35%, and C 40%.

A drew during the year 19..., £500; B drew during the year 19..., £400; C drew during the year 19..., £300.

The profits for 19... amounted to £3,000, before charging interest on capital (to which all are entitled) at 4%.

Give the Drawing Account of each partner on December 31, 19..., interest on drawings to be ignored. (*Chartered Accountants—Intermediate.*)

A. DRAWINGS ACCOUNT.

Dr. Cr.

19...		£	s.	d.	19...		£	s.	d.
Dec. 31	To Cash . . .	500	0	0	Jan. 1	By Balance . .	750	0	0
„ 31	„ Balance carried down . .	1,600	0	0	Dec. 31	„ Interest on Capital	200	0	0
					„ 31	„ Share of Profits .	1,150	0	0
		£2,100	0	0			£2,100	0	0
					19...				
					Dec. 31	By Balance brought down . .	1,600	0	0

B. DRAWINGS ACCOUNT.

Dr. Cr.

19...		£	s.	d.	19...		£	s.	d.
Dec. 31	To Cash . . .	400	0	0	Jan. 1	By Balance . .	500	0	0
„ 31	„ Balance carried down . .	1,030	0	0	Dec. 31	„ Interest on Capital	120	0	0
					„ 31	„ Share of Profits .	810	0	0
		£1,430	0	0			£1,430	0	0
					19...				
					Dec. 31	By Balance brought down . .	1,030	0	0

C. DRAWINGS ACCOUNT.

Dr. Cr.

19...		£	s.	d.	19...		£	s.	d.
Dec. 31	To Cash . . .	300	0	0	Jan. 1	By Balance . .	400	0	0
„ 31	„ Balance carried down . .	820	0	0	Dec. 31	„ Interest on Capital	80	0	0
					„ 31	„ Share of Profits .	640	0	0
		£1,120	0	0			£1,120	0	0
					19...				
					Dec. 31	By Balance brought down . .	820	0	0

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.		£	s.	d.	Cr.	£	s.	d.
To Interest on Capital:—					By Balance brought down . .	3,000	0	0
A	£200							
B	120							
C	80							
		400	0	0				
,, Balance carried down . .		2,600	0	0				
		£3,000	0	0		£3,000	0	0
					By Balance brought down . .	2,600	0	0
To A: $\frac{5}{10}$ of £2,000 .	£1,000							
25% of Balance	150							
		1,150	0	0				
,, B: $\frac{3}{10}$ of £2,000 .	600							
35% of Balance	210							
		810	0	0				
,, C: $\frac{2}{10}$ of £2,000 .	400							
40% of Balance	240							
		640	0	0				
		£2,600	0	0		£2,600	0	0

Portion of Junior Partner's Share Borne by Another.—Not infrequently in practice, a junior partner is admitted on the understanding that the whole or a portion of his share of the profits and partnership salary is to be borne by a senior partner. The sons of senior partners are sometimes introduced into the firm on some such arrangement. Such agreements involve no book-keeping difficulties, but they seem to confuse some students when confronted with them in examination questions.

Illustration 1.—George Dickson and G. McArthur are equal partners. They agree to admit Dickson's son, Hugh, as a partner on January 1, 19..., and allow him one-ninth share of the profits, such share to be borne by George Dickson. For the year ended December 31, 19..., the profits were £8,649. The division of profits would be as follows:—

Dickson & McArthur.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

(APPROPRIATION SECTION.)

Dr.				£	s.	d.	Cr.	£	s.	d.
							By Balance brought down . .	8,649	0	0
To George Dickson:—										
Share of Profits	£4,324	10	0							
Less Transfer to Hugh Dickson	961	0	0							
				3,363	10	0				
,, G. McArthur, Share of Profits .				4,324	10	0				
,, Hugh Dickson, Share of Profits .				961	0	0				
				£8,649	0	0		£8,649	0	0

Illustration 2.—Dickson and Chatenay, equal partners, admit McArthur as junior partner. The capital, bearing interest at 5%, is held as follows: Dickson, £10,000; Chatenay, £8,000. McArthur is to pay in £2,000 as capital. Salaries are to be credited as follows: Chatenay, £450; McArthur, £300. McArthur is to have one-eighth of the profits, but as Dickson is to be relieved of regular attendance at the office, it is agreed that as between Dickson and Chatenay one-half of McArthur's share of the profits and £200 of his salary is to be borne by Dickson.

Dickson, Chatenay & McArthur.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.		£	s.	d. Cr.
To Interest on Capital:— Dickson . £500 0 0 Chatenay . . 400 0 0 McArthur . . 100 0 0	1,000	0	0	By Balance brought down . .	9,830	0	0
Partnership Salaries:— Chatenay . .£450 0 0 McArthur . . 300 0 0	750	0	0				
,, McArthur ⅛ of Balance . .	1,010	0	0				
,, Balance carried down . .	7,070	0	0				
	£9,830	0	0		£9,830	0	0
To Dickson.	3,887	10	0	By Balance brought down . .	7,070	0	0
,, Chatenay	3,887	10	0	,, Dickson : ½ of McArthur's share . . £505 0 0 McArthur's salary 200 0 0	705	0	0
	£7,775	0	0		£7,775	0	0

DICKSON'S CURRENT ACCOUNT.

	£	s.	d.		£	s.	d.
To P. & L. Account . . .	705	0	0	By P. & L. Account . . .	3,887	10	0
,, Balance carried down . .	3,182	10	0				
	£3,887	10	0		£3,887	10	0
				,, Balance brought down . .	3,182	10	0

Sometimes a junior partner is admitted to a firm on the basis of a small share of the profits, accompanied by a senior partner's guarantee that the share of profits shall not be less than a named sum. Assume, for example, that A and B admit C to partnership with one-tenth share of the profits, A guaranteeing that C's share of profits shall not be less than £1,000 in any one year. If C's share of the profits at the close of any one year, amounted to, say, £875 only, then £125 must be debited to A's Current Account and credited to C's Current Account to transfer the amount. In the Appropriation Account, C will be credited with £875 only. If the minimum amount has been guaranteed by the firm, and not by an individual partner, the sum required to make up the guaranteed amount must be deducted from the shares of the other partners in the proportion in which they share profits.

Illustration.—A and B are partners. They admit C as a partner on the understanding that his share of the profits shall not be less than £1,200 in any one year. Profits are shared in the proportion one-half to A, three-eighths to B, one-eighth to C. The profits for the year ended December 31, 19..., were £7,800. The division of profits would be as follows:—

A, B & C.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

(Appropriation Section.)

Dr.				£	s.	d.	Cr.	£	s.	d.
To A, Share of Profits	£3,900	0	0				By Balance brought down . .	7,800	0	0
* *Less* Transfer to C, $\frac{4}{7}$ of £225 .	128	11	5	3,771	8	7				
,, B, Share of Profits	2,925	0	0							
* *Less* Transfer to C, $\frac{3}{7}$ of £225 .	96	8	7	2,828	11	5				
,, C, Share of Profits	975	0	0							
* *Add* Transfer from A	128	11	5							
Transfer from B	96	8	7	1,200	0	0				
				£7,800	0	0		£7,800	0	0

* These transfers can be made direct between the partners' current accounts, as explained above.

Where there is agreement between two or more partners for partnership salaries, the position is somewhat more complicated when the profits available are insufficient to meet partnership salaries and interest on capital.

Illustration.—Dickson, Chatenay, and Uprichard are partners. Capital bears 5% interest and is held as follows: Dickson, £6,000; Chatenay, £5,000. Dickson and Chatenay are equal partners. Uprichard, Dickson's nephew, was admitted to partnership on the terms that he was to be paid £300 as a partnership salary, £100 of which is to be borne by Dickson, and one seventh of the profits, also to be borne by Dickson. Dickson and Chatenay each take half of the profits. For the year ended December 31, 19..., the profits were £430. The Profit and Loss Account and the partners' Current Accounts would appear as follows:—

Dickson, Chatenay & Uprichard.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.		£	s.	d.	Cr.	£	s.	d.
To Partnership Salary (Uprichard) .		200	0	0	By Balance brought down . .	430	0	0
,, Interest on Capital * :—					,, Dickson, Share of Loss . .	160	0	0
Dickson . . .	£300				,, Chatenay, Share of Loss . .	160	0	0
Chatenay . . .	250	550	0	0				
		£750	0	0		£750	0	0

---

* In the above illustration it is assumed that, as is usual in practice, the agreement provides that interest on capital is to be credited even when profits are insufficient to meet it. In the absence of such agreement, interest would be "abated" in proportion to capital in order to adjust it to the amount of profits available to meet it, in view of the provisions of S. 24 [4], *Partnership Act*, 1890 (see p. 130).

DICKSON, CURRENT ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Transfer, U's Salary	100	0	0	19... Dec. 31	By Interest on Capital .	300	0	0
,, 31	,, Share of Loss .	160	0	0	,, 31	,, Transfer, U's $\frac{1}{7}$ Share of Loss of £320 .	45	14	3
,, 31	,, Balance carried down	85	14	3					
		£345	14	3			£345	14	3
					19... Jan. 1	By Balance brought down	85	14	3

CHATENAY. CURRENT ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Share of Loss .	160	0	0	19... Dec. 31	By Interest on Capital .	250	0	0
,, 31	,, Balance carried down	90	0	0					
		£250	0	0			£250	0	0
					19... Jan. 1	By Balance brought down	90	0	0

UPRICHARD. CURRENT ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Transfer from Dickson, Share of Loss	45	14	3	19... Dec. 31	By Partnership Salary .	200	0	0
,, 31	,, Balance carried down	254	5	9	,, 31	,, Transfer Salary from Dickson . .	100	0	0
		£300	0	0			£300	0	0
					19... Jan. 1	By Balance brought down	254	5	9

This illustration should be compared with that on p. 159; in the latter the agreement for the adjustments was between Dickson and Chatenay only, whereas in the above illustration the agreement is between *all* the partners, hence the different treatment in the books.

Goodwill in a Partnership.—Goodwill in its general aspect has been considered at pp. 90–93. In this place, we deal with the asset as and when it may occur in a partnership. Goodwill does not appear in the vast majority of partnership accounts. But certain events may compel the assessment of this asset. These are: (*a*) dissolution of partnership; (*b*) the death or retirement of a partner; (*c*) the admission of a new partner; and (*d*), often overlooked in practice, a change in the Profit and Loss sharing ratio. Probably, the majority of present-day partnership agreements define the basis upon which in case of need goodwill is to be valued. The student will understand the need for making an adjustment for goodwill in partnership accounts, when he reflects that upon the happening of any of the events (*a*), (*b*), (*c*) mentioned above, a *new firm* is brought into being.

For example, A and B, equal partners, have traded as A, B & Co. for fifteen years, and built up a prosperous business yielding an average profit of £5,000 per annum. To cope with increasing trade, they admit C to partnership; who, although he has done nothing to create the goodwill obviously attaching to the business, would be entitled to his proportionate share of the profits derived from the goodwill, and to a share in the value of that asset should dissolution or death occur. In order, therefore, that the claims of the old partners who built up the goodwill may be dealt with equitably, it is decided to compensate them by creating a Goodwill Account, and to credit each of them with £5,000, being two years' average profits.

Consider a somewhat extreme case by way of further illustration of the need for taking goodwill into account on the admission of a new partner. A and B admit C to partnership on the terms that he is to pay in £3,000 as capital and to have one-fifth of the profits. Goodwill is not taken into account. Unforeseen circumstances arise, and the business has to be sold three months after C's admission. The goodwill realises £5,000. C is thus entitled to his share of this paper profit of £5,000, notwithstanding that he had no part in creating the goodwill.

Again, D, E, and F have together built up a prosperous business. If D should die, would it be equitable that E and F should succeed to the whole of the goodwill to the exclusion of the representatives of D, who presumably took a prominent part in its foundation ?

Admission of New Partner.—The admission of a new partner is the most common occasion for the creation of a goodwill account in partnership books.

Illustration.—A and B are partners in an old-established business. The Balance Sheet of the firm at December 31, 19..., was as follows:—

A & B.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Sundry Assets	18,700	0	0
A	£10,000				Cash at Bank	1,985	0	0
B	8,000							
		18,000	0	0				
Creditors		2,685	0	0				
		£20,685	0	0		£20,685	0	0

On January 1, 19..., it is agreed to admit to partnership C, who is to provide £4,000 as capital and to pay A and B £1,000 by way of premium for a quarter share of profits. C's cash resources do not, however, exceed £4,000, and he pays this in as capital. In lieu of the premium otherwise payable in cash, it is agreed that a Goodwill Account of £4,000 should be created, and a similar amount should be credited to A and B in the same proportion in which they share profits. The old partners thus surrender their claim for the cash premium, and become creditors of the firm for their respective shares of the goodwill credited to their Capital Accounts, and also benefit from the interest accruing on the additional capital standing to their credit. The Balance Sheet of the new firm would appear as follows:—

A, B & C.

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.		£	s.	d.
Capital :—					Goodwill	4,000	0	0
A	£12,000				Sundry Assets	18,700	0	0
B	10,000				Cash at Bank	5,985	0	0
C	4,000	26,000	0	0				
Creditors		2,685	0	0				
		£28,685	0	0		£28,685	0	0

Premium for Admission of New Partner.—Frequently, the claims of the founders of a partnership goodwill are recognised by a new partner paying an agreed sum in cash as a premium for his admission to the firm and a share of its goodwill. There is no need, in such cases, to open a goodwill account in the books, or to make any entries whatever. The transaction is a *private* one between the old partners and the new partner, and does not affect the financial position of the firm. But the partners may desire to have a record of the transaction in the books of the new firm, and this could be done in the manner shown below, or by means of the alternative entries given in the illustration at p. 164.

Illustration.—A and B are equal partners. They admit C to partnership as on January 1, 19..., on the terms that he is to pay £2,000 premium for his admission and to introduce £3,000 as capital.

1 CASH BOOK. 1

Dr. Cr.

				£	s.	d.				£	s.	d.
19...												
Jan. 1	To C, Cash :—											
	Capital	£3,000	3									
	Goodwill	2,000	2	5,000	0	0						

2 GOODWILL ACCOUNT. 2

Dr. Cr.

			£	s.	d.				£	s.	d.
19...						19...					
Jan. 1	To Transfer :—					Jan. 1	By Cash (C)	1	2,000	0	0
	A's Capital Account	4	1,000	0	0						
	B's Capital Account	5	1,000	0	0						

3 C. CAPITAL ACCOUNT. 3

Dr. Cr.

			£	s.	d.				£	s.	d.
						19...					
						Jan. 1	By Cash	1	3,000	0	0

4 A. CAPITAL ACCOUNT. 4

Dr. Cr.

			£	s.	d.				£	s.	d.
						19...					
						Jan. 1	By Balance	√	5,000	0	0
						,, 1	,, Goodwill Account	2	1,000	0	0
									£6,000	0	0

5 B. CAPITAL ACCOUNT. 5

Dr. Cr.

	£	s.	d.				£	s.	d.
				[illegible]	By Balance		[illegible]		
				[illegible]	,, [illegible] A/c		[illegible]		
							[illegible]		

Illustration.—B. Black and W. White are partners and share profits and losses as to two-thirds to Black and one-third to White. Black contributed £10,000 capital, and White £7,500. They admit to partnership G. Green, who is to pay in £5,000 as capital and £3,000 by way of premium for admission. Green stipulates that the premium shall be left in the business in order to strengthen the firm's financial position. The necessary entries are as follows:

Black & White.

32 CASH BOOK. 32

Dr. Cr.

		P.L.	£	s.	d.		£	s.	d.
To Green:—									
Capital	£5,000	3							
Premium	3,000	1, 2							
			8,000	0	0				

PRIVATE LEDGER.

1 B. BLACK. CAPITAL ACCOUNT. 1

Dr. Cr.

	£	s.	d.			£	s.	d.
				By Balance	✓	10,000	0	0
				,, ⅔ Premium from Green	C.B. 32	2,000	0	0
						£12,000	0	0

2 W. WHITE. CAPITAL ACCOUNT. 2

Dr. Cr.

	£	s.	d.			£	s.	d.
				By Balance	✓	7,500	0	0
				,, ⅓ Premium from Green	C.B. 32	1,000	0	0
						£8,500	0	0

3 G. GREEN. CAPITAL ACCOUNT.

Dr. Cr.

	£	s.	d.		£	s.	d.
				By Cash	5,000	0	0

If no agreement was made regarding the retention of the premium in the business, but there was a desire to record the payment of the premium in the books of the firm, the only entries would be:—

CASH BOOK.

Dr. Cr.

			£	s.	d.				£	s.	d.
	To Green :—						By Cash :—				
	Capital .	£5,000					Black, ⅔ Premium	£2,000			
	Premium	3,000	8,000	0	0		White, ⅓ Premium	1,000	3,000	0	0

The above transactions would be posted as follows:—

Capital, G. Green, £5,000, to the credit of his Capital Account in the Private Ledger.

Premium, £3,000, as to £2,000 (two-thirds) to the credit of Black's Current Account, and as to £1,000 (one-third) to the credit of White's Current Account.

Cash, £3,000, as to £2,000 to the debit of Black's Current Account as an ordinary drawing, and as to £1,000 to the debit of White's Current Account.

EXAMINATION QUESTION.

F and G agree to admit H as a partner as from January, 1, 19..., upon the following terms: (*a*) H to bring in £5,000, of which £1,500 is to be regarded as a premium and credited equally to F and G. (*b*) Profits to be divided as follows: F and G, two-fifths each; H, one-fifth.

The Balance Sheet of F and G at December 31 last, was as under:—

Liabilities.		£ s. d.	Assets.		£ s. d.
Creditors		5,790 10 0	Plant, etc. . .	£15,300	
Capital—			*Less* Depreciation .	3,300	12,000 0 0
F	£8,500		Debtors . . .	4,600	
G	8,500	17,000 0 0	*Less* Provision .	940	3,660 0 0
			Stock		5,720 6 8
			Bank		1,410 3 4
		£22,790 10 0			£22,790 10 0

Draft the Balance Sheet of the new firm on January 1.

Solution.

CASH BOOK.

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Jan. 1	To Cash, H :—										
	Capital . .		3,500	0	0						
	Premium :—										
	F . .	£750									
	G . .	750	1,500	0	0						

F, G & H.

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.			£	s.	d.
Capital :—					Plant, etc. . .	£15,300			
F	£9,250				*Less* Depreciation .	3,300	12,000	0	0
G	9,250				Debtors . . .	4,600			
H	3,500	22,000	0	0	*Less* Provision .	940	3,660	0	0
Creditors		5,790	10	0	Stock		5,720	6	8
					Bank		6,410	3	4
		£27,790	10	0			£27,790	10	0

Examination candidates frequently fail to understand that, in circumstances such as those dealt with in the illustration at p. 164, *no goodwill account should be opened.* The premium has been paid in place of a goodwill account. Examination questions frequently deal with the admission of a new partner who pays in cash capital, and a further sum as the "purchase price of a share in the unrecorded goodwill." In answering such questions, it is quite inaccurate to open a goodwill account. The premium is to be divided between the old partners in the same proportion in which those partners shared profits and losses, as shown in the illustration given above. It is very important that the student should realise that in all cases where a new partner is admitted to a firm *a new firm has come into existence*, and that henceforth the new partner has equal rights with the old partners in the management of the business and to a share in the goodwill, subject, of course, to any modifications that may be imposed by the articles of partnership.

Premium Paid for Fixed Partnership Term.—Where a premium has been paid for a fixed partnership term, and dissolution occurs before the expiration of the fixed term, the partner paying the premium has the right (by S. 40 of the *Partnership Act*, 1890) to apply to the Court for repayment of the premium, or such part thereof as may be deemed just having regard to the actual duration of the partnership. As a general rule, judgment in such cases follows the judgment in *Atwood* v. *Maud* (1868), L.R. 3 Ch. 369, and repayment is ordered to be made on a time basis, *i.e.* according to the proportion which the unexpired part of the partnership bears to the whole term agreed upon.

Goodwill on Partner's Death or Retirement.—Unless the partnership agreement directs that on the death or retirement of a partner the goodwill is to pass to the remaining partners, either event necessitates the valuation of the goodwill. A goodwill exists, and it is an asset in which all the partners are entitled to share, including the retiring, or the representatives of a deceased, partner.

Modern partnership agreements usually define the basis upon which goodwill is to be valued when the need arises. Sometimes (*a*) its value is fixed at a definite sum, or (*b*) its value may be based upon the average profits of a stated number of years, or (*c*) it may be valued on a basis of turnover of specified years, or (*d*) it may be valued by an independent accountant or other person on all the facts known to him. Occasionally (*e*) varying amounts are agreed as representing the goodwill value of the individual partners. In such cases, an endeavour is made to assess the goodwill loss which would be sustained by the firm by the death of each partner. For example, the death of the founder, and senior partner, of a firm might greatly reduce the value of the goodwill passing to the surviving partners. Such treatment needs delicate handling, and is infrequently met with.

If the partnership agreement lays down no basis for determining the value of the goodwill, its value must be settled by agreement between the partners, or by arbitration, or, in the last resort, by litigation, or by sale for the best price it will command (*re David and Matthews*, [1899], 1 Ch. 378).

Illustration.—A, B, and C are in partnership sharing profits respectively in the proportion three-sixths, two-sixths, and one-sixth. B dies on November 1, 19... The articles provide that, in the event of a partner's death, goodwill is to be valued at an amount equal to the average profits of the three years ended on December 31 next following the death. The Balance Sheet at that date is to form the basis on which the representatives of the deceased are to be paid out. Profits for the three years were: £8,150, £6,400, £8,850—an average profit of £7,800. The Balance Sheet of the firm at December 31, 19..., following the death, excluding goodwill, was as follows:—

A, B & C.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Freehold Property . . .	12,876	0	0
A	£10,000				Machinery and Plant . .	7,224	0	0
B	7,800				Sundry Assets	11,300	0	0
C	5,722							
		23,522	0	0				
Creditors		7,878	0	0				
		£31,400	0	0		£31,400	0	0

In order to carry out the provisions of the partnership agreement, a goodwill account must be opened equal in amount to the average of the three years' profits, viz. £7,800, and a like amount must be credited to the capital accounts of the partners in the same proportions as profits are shared. The new Balance Sheet, including the goodwill, will appear as follows:—

A, B & C.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Goodwill Account . . .	7,800	0	0
A: Balance . .	£10,000				Freehold Property . . .	12,876	0	0
Share of Goodwill	3,900				Machinery and Plant . .	7,224	0	0
		13,900	0	0	Sundry Assets	11,300	0	0
B: Balance . .	7,800							
Share of Goodwill	2,600							
		10,400	0	0				
C: Balance . .	5,722							
Share of Goodwill	1,300							
		7,022	0	0				
Sundry Creditors . . .		7,878	0	0				
		£39,200	0	0		£39,200	0	0

The balance shown in this way to be due to B's representatives must be paid out in accordance with the articles of partnership. Usually, two, or more, years are allowed for payment of the sum due, in half-yearly instalments of agreed amount with interest at 5% per annum on the balance outstanding.

The surviving partners, A and C, have now become sole owners of the goodwill, and can, if they so desire, eliminate the asset from the books.

Illustration.—Take the above details, and assume that, upon B's death, A and C now agree (for a consideration as between A and C) to share profits in the proportion of two-thirds and one-third respectively, and that they have decided to write off the goodwill. The entries required are given below:—

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Sundries:—	Dr.						
	A, Capital Account		5,200	0	0			
	C, Capital Account		2,600	0	0			
	To Goodwill Account					7,800	0	0
	Being transfer of the latter account to eliminate the asset from the books.							

As an alternative, and to avoid opening a goodwill account, A and C could have passed the necessary credit to B's capital account (on the old profit-sharing basis) by the following entry:—

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Sundries:—	Dr.						
	A, Capital Account		1,950	0	0			
	C, Capital Account		650	0	0			
	To B, Capital Account					2,600	0	0
	Being share of goodwill due to the representatives of B as per terms of the partnership agreement.							

A further journal entry would then have been necessary to adjust the goodwill in view of the change in A and C's profit-sharing ratio:—

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	C, Capital Account	Dr.	650	0	0			
	To A, Capital Account					650	0	0
	Transfer of $\frac{1}{12}$ of Goodwill from C to A on the alteration of A's profit-sharing ratio from $\frac{9}{12}$ to $\frac{8}{12}$, and C's from $\frac{3}{12}$ to $\frac{4}{12}$ in the terms of the new agreement.							

Goodwill Partly Paid for in Kind.—It sometimes happens that when two businesses are amalgamated, the absorbing firm accepts the transfer of certain assets from the smaller business by way of part purchase for the goodwill.

Illustration.—George and Hugh Dickson are equal partners in a cigarette-manufacturing business. Their Balance Sheet at December 31, 19..., was as follows:—

G. & H. Dickson.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Freehold Factory	24,785	0	0
G. Dickson	£15,000				Machinery and Plant	4,745	0	0
H. Dickson	14,500	29,500	0	0	Stock	9,404	0	0
Sundry Creditors		11,486	0	0	Sundry Debtors	2,052	0	0
Bills Payable		1,895	0	0	Cash	1,895	0	0
		£42,881	0	0		£42,881	0	0

On January 1, 19..., the partners agree to admit A. Chatenay, also a cigarette manufacturer, as a partner, on the following terms: Chatenay is to pay £2,000 to G. and H. Dickson as premium for admission, and also to contribute £6,000 as capital. It is agreed that in part payment of the latter sum certain of Chatenay's business assets shall be taken over at the following valuations: Machinery and Plant, £1,956; Stock, £2,194; Sundry Debtors, £900, less 5% reserve for bad debts. The premium to be paid by A. Chatenay is to be left in the business as additional capital. The book-keeping record is as follows:—

CASH BOOK.

1 Dr. Cr. 2

			£	s.	d.				£	s.	d.
19... Jan. 1	To Balance brought forward . .	√	1,895	0	0						
" 1	" Cash. A. Chatenay, Premium:— G. Dickson £1,000 H. Dickson 1,000	 2 4	2,000	0	0						
" 1	" Cash. A. Chatenay, Balance to make up Capital Account to £6,000 .	6	995	0	0						
			£4,890	0	0						

JOURNAL.

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
19... Jan. 1	Sundries:— Dr.							
	Machinery and Plant	11	1,956	0	0			
	Stock	13	2,194	0	0			
	Debtors	15	900	0	0			
	To A. Chatenay, Capital Account . . .	6				5,050	0	0
	For Sundry Assets taken over this day in part discharge of Capital to be paid in.							
" 1	A. Chatenay, Capital Account . . . . Dr.	5	45	0	0			
	To Bad Debts Reserve	8				45	0	0
	For Reserve on Book Debts taken over as agreed.							

LEDGER.

G. Dickson. Capital Account.

1 Dr. Cr. 2

			£	s.	d.				£	s.	d.
						19... Jan. 1	By Balance . .	√	15,000	0	0
						" 1	" Cash, ½ Premium	C.B. 1	1,000	0	0
									£16,000	0	0

H. Dickson. Capital Account.

3 Dr. Cr. 4

			£	s.	d.				£	s.	d.
						19... Jan. 1	By Balance . .	√	14,500	0	0
						" 1	" Cash, ½ Premium		1,000	0	0
									£15,500	0	0

LEDGER—*continued.*

A. CHATENAY. CAPITAL ACCOUNT.

5 Dr. | 6 Cr.

19...		J.	£	s.	d.	19...		J.	£	s.	d.
Jan. 1	To Bad Debts Provision . .	1	45	0	0	Jan. 1	By Sundry Assets	1	5,050	0	0
,, 1	,, Balance carried down . .	√	6,000	0	0	,, 1	,, Cash . .	C.B. 1	995	0	0
			£6,045	0	0				£6,045	0	0
						19...					
						Jan. 1	By Balance brought down . .	√	6,000	0	0

BAD DEBTS PROVISION.

7 Dr. | 8 Cr.

			£	s.	d.	19...		J.	£	s.	d.
						Jan. 1	By Transfer (Chatenay's Capital Account) .	1	45	0	0

FREEHOLD FACTORY.

9 Dr. | 10 Cr.

19...			£	s.	d.				£	s.	d.
Jan. 1	To Balance . .	√	24,785	0	0						

MACHINERY AND PLANT.

11 Dr. | 12 Cr.

19...			£	s.	d.				£	s.	d.
Jan. 1	To Balance . .	√	4,745	0	0						
,, 1	,, Sundries (A. Chatenay) .	J.1	1,956	0	0						
			£6,701	0	0						

STOCK.

13 Dr. | 14 Cr.

19...			£	s.	d.				£	s.	d.
Jan. 1	To Balance . .	√	9,404	0	0						
,, 1	,, Sundries (A. Chatenay) .	J.1	2,194	0	0						
			£11,598	0	0						

SUNDRY DEBTORS.

15 Dr. | 16 Cr.

19...			£	s.	d.				£	s.	d.
Jan. 1	To Balance . .	√	2,052	0	0						
,, 1	,, Sundries (A. Chatenay) .	J.1	900	0	0						
			£2,952	0	0						

LEDGER—*continued.*

17 SUNDRY CREDITORS. 18

Dr. Cr.

	£	s.	d.				£	s.	d.
				19... Jan. 1	By Balance . .	√	11,486	0	0

19 BILLS PAYABLE. 20

Dr. Cr.

	£	s.	d.				£	s.	d.
				19... Jan. 1	By Balance . .	√	1,895	0	0

The Balance Sheet of the firm after the admission of A. Chatenay would appear as follows:—

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.			£	s.	d.
Capital:—					Freehold Factory . . .		24,785	0	0
G. Dickson . .	£16,000				Machinery and Plant . . .		6,701	0	0
H. Dickson . .	15,500				Stock		11,598	0	0
A. Chatenay . .	6,000				Sundry Debtors .	£2,952			
		37,500	0	0	*Less* Provision .	45			
Sundry Creditors		11,486	0	0			2,907	0	0
Bills Payable		1,895	0	0	Cash		4,890	0	0
		£50,881	0	0			£50,881	0	0

Guarantees on Amalgamation.—It sometimes happens when businesses are amalgamated, or assets are taken over in lieu of cash, as illustrated in the above example, that an agreement is entered into by the incoming partner guaranteeing the book value of such assets. The original parties may also, on their part, guarantee the value of some of their assets, *e.g.* book debts. They may also undertake that their liabilities shall not exceed the amount at which they stand in the Amalgamation Balance Sheet. Should the assets not realise the guaranteed book values or the liabilities exceed the guaranteed limit, the differences must be treated as personal debts due from the guarantors. They may be made good either by cash payment or by a debit to the Capital Account or Accounts concerned.

Illustration.—Assume the details given in the previous illustration, and that the assets taken over from A. Chatenay were guaranteed by him to be of the values stated in the Journal entry dated June 1, 19... A subsequent independent valuation of the Machinery and Plant was made, and its value was fixed at £1,895. The necessary adjustment is as follows:—

JOURNAL.

			Dr.			Cr.		
19...		L.F.	£	s.	d.	£	s.	d.
Feb. 14	A. Chatenay, Capital Account . . . . Dr.		61	0	0			
	To Machinery and Plant Account . . .					61	0	0
	Being shortage in the value of this asset guaranteed at £1,956 and now valued at £1,895.							

Summary of Treatment of Goodwill.—In view of the confusion shown by some examination candidates in the treatment of goodwill, it may be useful to summarise the various ways in which goodwill may arise in partnership accounts and its proper treatment.

(A) *Data.*—New partner is to pay the old partners a fixed amount, £2,000, for a share of unrecorded goodwill, and is to introduce an agreed amount, £5,000, as capital.

Entries.—No entries are required in the books of the new firm for the £2,000 goodwill. The amount will be paid *direct* to the old partners in the proportion in which they shared profits. This £2,000 is not paid into the firm's account, but privately to the old partners, unless, of course, they agree to pay it in as additional capital as in (*c*). The £5,000 capital will be debited on receipt to Cash and posted to the credit of the new partner's Capital Account. *No goodwill account is to be opened.*

(B) *Data.*—An agreed amount, £2,000, is to be treated as the value of the firm's goodwill. The new partner is to pay in £5,000 as capital.

Entries.—A Goodwill Account must be opened and debited with £2,000. The Capital Accounts of the old partners must be *credited* with £2,000 in the proportions in which they shared profits. The £5,000 paid in by the new partner will be treated as in A above.

(C) *Data.*—The new partner is to pay £2,000 for a share of goodwill and the amount is to be left in the business. He is also to pay in £5,000 as capital.

Entries.—The £2,000 for goodwill must be debited to cash on receipt, and posted to the credit of the Capital Accounts of the old partners in the proportion in which they shared profits. The £5,000 paid in as capital will be treated as in A and B above. *No goodwill account is to be opened.*

(*D*) *Data.*—On the death (or retirement) of a partner, goodwill is to be valued in accordance with the terms of the partnership deed; for example, it is to be taken as of the value of the average profits for the three years ended on December 31 next following the death (or retirement) of the partner.

Entries.—Assuming that the average of the three years' profits is, *e.g.* £5,000, open a Goodwill Account and debit it with £5,000, and credit the like sum to the Capital Accounts of the partners, including that of the deceased (or retiring) partner, in the proportion in which profits are shared. The books will then show the amount to be accounted for to the representatives of the deceased, or to the retiring, partner.

EXAMINATION QUESTION.

Blank found himself in the position disclosed in the following statement on December 31 :—

Liabilities.	£	Assets.	£
Sundry Creditors . . .	3,630	Sundry Debtors	2,082
Preferential Creditors . .	185	Bills Receivable	120
Bank Overdraft . . .	250	Stock	942
Abel Chatenay (loan) . .	800	Machinery	1,000
		Cash in hand	15
		Deficiency	706
	£4,865		£4,865

The following arrangements were entered into with the parties concerned.

The preferential creditors and the bankers were to be paid in full. The trade creditors were to accept 15*s.* in the £ in full settlement. Abel Chatenay was to join Blank as a partner, introducing £2,000 into the business, and the loan of £800 was to be transferred to his capital account. The Sundry Debtors were valued at £1,740. The Stock was written down to £700, and the Machinery to £800. Any profit or loss arising out of the above settlement was to be carried to Blank's Capital Account.

Prepare a statement showing the position of the new firm upon the completion of the above settlement. (*London Chamber Commerce.*)

Solution.

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Sundry Creditors	Dr.	907	10	0			
	To Realisation Account					907	10	0
	Being 5*s.* in the £ written off these debts.							
„ 31	Realisation Account	Dr.	784	0	0			
	To Sundry Assets :—							
	Sundry Debtors					342	0	0
	Stock					242	0	0
	Machinery					200	0	0
	Being loss on revaluation of these assets.							
„ 31	Realisation Account	Dr.	123	10	0			
	To Blank, Capital Account					123	10	0
	Being profit on rearrangement of business.							

BLANK. CAPITAL ACCOUNT.

Dr.		£	s.	d.		Cr.	£	s.	d.
19... Dec. 31	To Balance . .	706	0	0	19... Dec. 31	By Realisation Account	123	10	0
					„ 31	„ Balance carried down . .	582	10	0
		£706	0	0			£706	0	0
19... Dec. 31	To Balance brought down . .	582	10	0					

Blank and Chatenay.

BALANCE SHEET, DECEMBER 31, 19.

	£	s.	d.		£	s.	d.
Capital:—				Sundry Debtors	1,740	0	0
Chatenay	2,800	0	0	Bills Receivable	120	0	0
Bank Overdraft	250	0	0	Stock	700	0	0
Sundry Creditors	2,722	10	0	Machinery	800	0	0
Preferential Creditors . . .	185	0	0	Cash in hand	15	0	0
				Cash at Bank	2,000	0	0
				Blank (debit balance of Capital Account)	582	10	0
	£5,957	10	0		£5,957	10	0

Share of Late Partner Continued as Loan.—Articles of partnership sometimes provide that when the amount due to a deceased partner has been ascertained, it shall be treated as a loan, carrying interest at an agreed rate, and be payable in a stated number of instalments at fixed intervals. In such cases, the capital account of the deceased partner is credited with interest at the agreed rate, and debited with the instalments as and when paid.

Illustration.—B. Black, W. White, and C. Brown were in partnership. Black died, and the amount due to him as on the date of death was agreed with his representatives at £5,080. By the partnership articles this sum was repayable in ten equal yearly instalments, and interest at 5% per annum on the current balance was to be paid in cash at the close of each year. Assuming the death of Black to have taken place on December 31, 19..., the Capital Account on the following December 31 would appear as follows:—

B. BLACK (THE LATE). LOAN ACCOUNT.

Dr. Cr.

			£	s.	d.				£	s.	d.
19...						19...					
Dec. 31	To Cash (1st Instalment) . .	C.B.	508	0	0	Dec. 31	By Transfer from Capital Account.	J.	5,080	0	0
,, 31	,, Cash (Interest).		254	0	0	19...					
,, 31	,, Balance carried down . .	√	4,572	0	0	Dec. 31	,, Interest at 5% .	J.	254	0	0
			£5,334	0	0				£5,334	0	0
						19...					
						Dec. 31	By Balance brought down . .		4,572	0	0

Survivorship Assurance Policies.—A modern practice, growing in popularity, is to take out a partnership joint policy of assurance for an agreed sum, so that upon the death of a partner the proceeds of the policy become available to discharge the amount due to the representatives of the partner. In this way, undue strain upon the firm's financial resources is avoided. The annual premiums are charged against the firm's Profit and Loss Account. When, owing to death or maturity of the policy, the sum assured is received, it represents accumulated undivided profits, divisible in the proportions in which the partners share profits and losses, and is credited to the Capital Accounts.

Illustration.—P. Helyet, C. Testout, and A. Pillar are in partnership, sharing profits respectively in the proportion one-half, one-quarter, one-quarter. Helyet has contributed £15,000 Capital; Testout, £7,500; and Pillar, £6,000. Interest at 5% is allowed on capital, but no interest is charged on drawings. Testout and Pillar are each credited with a partnership salary of £500 on December 31 of each year. On the death of a partner, goodwill is to be valued at one year's purchase of the average profit for the three years immediately preceding the death. A policy of assurance for £12,000 is to be taken out on the joint lives of the three partners. Testout died on December 31, 19... His drawings for the year ended on the same date were £2,286. The results of the firm's trading for the three years ended on the date of death were £7,878 (profit), £5,278 (profit), but for the year of Testout's death a loss of £480. After the necessary adjustments, C. Testout's Capital and Current Accounts would appear as follows:—

C. TESTOUT. CAPITAL ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Balance carried down . . .	11,556	6	8	19... Dec. 31	By Balance . .	7,500	0	0
					„ 31	„ Share of Goodwill (¼ of £4,225 6s. 8d.)	1,056	6	8
					„ 31	„ Share of Assurance Policy (¼ of £12,000)	3,000	0	0
		£11,556	6	8			£11,556	6	8
					19... Dec. 31	By Balance brought down . .	11,556	6	8

C. TESTOUT. CURRENT ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Drawings . .	2,286	0	0	19... Dec. 31	By Interest on Capital	375	0	0
„ 31	„ Share of Loss .	120	0	0	„ 31	„ Salary . .	500	0	0
					„ 31	„ Balance carried down . .	1,531	0	0
		£2,406	0	0			£2,406	0	0
19... Dec. 31	To Balance brought down . . .	1,531	0	0					

GOODWILL VALUATION.

	£	s.	d.		£	s.	d.
1st Year Profit	7,878	0	0				
2nd Year Profit	5,278	0	0				
	13,156	0	0				
Less 3rd Year Loss	480	0	0				
	£12,676	0	0				
One year's purchase	4,225	6	8				

Partners sometimes prefer not to charge the whole of the premiums to Profit and Loss Account. A "Life Policy Account" is then opened, and that portion of the annual premium which is represented by the increased surrender value of the policy is credited to "Life Policy

Premium Account," and debited to "Life Policy Account." By this method, the latter account shows at any time the present surrender value of the policy. When the policy matures, the amount received from the assurance company is credited to "Life Policy Account" and the balance in excess of the surrender value is divided between the partners.

Illustration.—Dickson and Jones are equal partners. They have taken out a joint policy for £5,000 at an annual premium of £135. After the policy has been running for some years, Dickson dies. The amount due under the policy was paid on December 31, 19... The following Ledger accounts concern the policy:—

1 LIFE POLICY PREMIUM ACCOUNT. 2

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Cash, Annual Premium . .	C.B.	135	0	0	19... Dec. 31	By Transfer to Life Policy Account (increase in surrender value) .	3	45	0	0
						,, 31	,, Profit and Loss Account .	P.L.	90	0	0
			£135	0	0				£135	0	0

3 LIFE POLICY ACCOUNT. 4

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance (surrender value at date) . .	√	2,563	0	0	19... Dec. 31	By Cash, Proceeds of Policy . .	C.B.	5,000	0	0
,, 31	,, Transfer from Life Policy Premium Account .	2	45	0	0						
,, 31	,, Dickson, Capital Account (share of balance) .		1,196	0	0						
,, 31	,, Jones, Capital Account (share of balance) .		1,196	0	0						
			£5,000	0	0				£5,000	0	0

New Partner and Revaluation of Assets.—The admission of a new partner may afford a favourable opportunity to revalue some of the assets of the old firm, indeed a new partner may make this a condition of his entry as partner. Some of the assets may have appreciated in value above their book values, others, on the other hand, may have depreciated. Freehold property, for example, may be retained in the books at its original cost, notwithstanding that it has greatly increased in value. Plant and Machinery may appear at a figure above its actual market value. Appreciations and depreciations disclosed upon revaluation, or agreed upon by mutual consent, must be treated as partnership profits and losses and be divided between the partners in the proportions in which profits and losses are shared.

Illustration.—G. Dickson and A. Chatenay are equal partners. On January 1, 19..., they agree to admit G. Wand as partner. Wand is to pay £2,000 as a premium—the money to be left in the business—and contribute £5,000 as capital. The Balance Sheet of the old firm as at December 31, 19..., was as follows:—

Dickson & Chatenay.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Freehold Property . . .	7,962	0	0
G. Dickson . .	£10,000				Machinery and Plant . . .	6,841	0	0
A. Chatenay . .	8,000				Sundry Debtors . . .	10,210	0	0
		18,000	0	0	Stock	3,528	0	0
Sundry Creditors . . .		7,862	0	0	Bank (Current Account) . .	321	0	0
Bank Loan		2,000	0	0				
Reserve Account . . .		1,000	0	0				
		£28,862	0	0		£28,862	0	0

It was agreed after negotiation between the parties that the following adjustments in the book values were to be made:—

	£
(*a*) Freehold Property to be valued at	12,000
(*b*) Machinery and Plant to be reduced to	5,000
(*c*) Bad Debts to the amount of £749 to be written off .	749
(*d*) Stock to be valued at	3,000

(*e*) Reserve Account to be transferred to Revaluation Account.

The Revaluation Account would appear as follows:—

REVALUATION ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Machinery and Plant (Depreciation)	1,841	0	0	By Freehold Property (Appreciation)	4,038	0	0
,, Bad Debts (written off) . .	749	0	0	,, Reserve Account (transfer) .	1,000	0	0
,, Stock (amount written off) .	528	0	0				
,, Balance carried down . .	1,920	0	0				
	£5,038	0	0		£5,038	0	0
To G. Dickson, Capital Account .	960	0	0	By Balance brought down . .	1,920	0	0
,, A. Chatenay, Capital Account .	960	0	0				
	£1,920	0	0		£1,920	0	0

The Balance Sheet of the new firm, as at January 1, 19..., would appear as shown on p. 178.

EXAMINATION QUESTION.

George McArthur and Arthur Hadley were equal partners. McArthur died on December 30, 19... Accounts were prepared at the close of the financial year (December 31), when it was found, after ascertaining and crediting the profit for the previous year in the ordinary way, that the partners' accounts stood as follows: McArthur, Capital Account, £8,000; Current Account (Credit Balance), £962. Hadley, Capital Account, £7,000; Current Account (Credit Balance), £852.

It was agreed with McArthur's executors that the value of the Goodwill, which had not hitherto appeared in the books, should be fixed at £3,000, and that the assets and liabilities should be reviewed. Valuations were made with the following results: The book value of the Plant and Machinery was reduced by £500; the Provision for Bad Debts was found to be excessive by £200; the Stock was undervalued by £350; the Sundry Creditors were over-stated by £670; and the Patents (book value, £300) were held to be of no value.

Dickson, Chatenay & Wand.

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.	£	s.	d.
Capital—							
G. Dickson . .	£10,000						
½ Share Premium	1,000						
½ Share Revaluation	960	11,960	0	0			
A. Chatenay . .	£8,000						
½ Share Premium	1,000						
½ Share Revaluation	960	9,960	0	0			
G. Wand		5,000	0	0	26,920	0	0
Sundry Creditors . . .					7,862	0	0
Loan Bank					2,000	0	0
					£36,782	0	0

	£	s.	d.	£	s.	d.
Freehold Property . . .	7,962	0	0			
Add Appreciation . .	4,038	0	0	12,000	0	0
Machinery and Plant . .	6,841	0	0			
Less Depreciation . .	1,841	0	0	5,000	0	0
Sundry Debtors . . .	10,210	0	0			
Less Bad Debts . . .	749	0	0	9,461	0	0
Stock	3,528	0	0			
Less Amount written off .	528	0	0	3,000	0	0
Bank (Current Account) . .	321	0	0			
Add Cash paid in by G. Wand	7,000	0	0	7,321	0	0
				£36,782	0	0

Submit the partners' accounts as they would appear in the Revaluation Balance Sheet. (*Royal Society Arts.*)

Solution.

REVALUATION ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Plant and Machinery (Depreciation) .	500	0	0	19... Dec. 31	By Goodwill . .	3,000	0	0
,, 31	,, Patents (written off)	300	0	0	,, 31	,, Provision for Bad Debts (excess) .	200	0	0
,, 31	,, Balance carried down . .	3,420	0	0	,, 31	,, Stock (appreciation)	350	0	0
					,, 31	,, Sundry Creditors (overstatement) .	670	0	0
		£4,220	0	0			£4,220	0	0
19... Dec. 31	To McArthur, Capital Account . .	1,710	0	0	19... Dec. 31	By Balance brought down . .	3,420	0	0
,, 31	,, Hadley, Capital Account . .	1,710	0	0					
		£3,420	0	0			£3,420	0	0

McArthur & Hadley.

REVALUATION BALANCE SHEET, DECEMBER 31, 19...

(PARTNER'S ACCOUNTS ONLY.)

Dr. Cr.

		£	s.	d.		£	s.	d.
Capital :—								
G. McArthur . .	£8,000				*Note.*—It would be equally correct to carry one half-share of the goodwill, as a separate item, to the credit of each partner.			
Share of revaluation profit	1,710	9,710	0	0				
A. Hadley . .	7,000							
Share of revaluation profit	1,710	8,710	0	0				
Current Accounts :—								
G. McArthur . .	£962							
A. Hadley . .	852	1,814	0	0				

Amalgamation of Two Businesses.—Not infrequently, two or more sole traders engaged in the same trade, or two or more sole professional practitioners, agree to amalgamate their assets and liabilities to form a partnership. In such circumstances the Balance Sheet of each business or profession usually requires careful revision, and agreement must first be reached as to any adjustments in the value of the assets or the extent of the liabilities that may be necessary. In some cases the goodwill of the amalgamating concerns may be conspicuously unequal in value, and equitable recognition of the inequality must be effected in the books of the new partnership. The book-keeping principles involved are precisely the same as in the case of amalgamating limited companies (see pp. 464 *et seq.*). The Balance Sheet of each of the amalgamating parties must be re-drafted to accord with the adjustments agreed upon, and the re-drafted Balance Sheets combined will then form the initial Balance Sheet of the new partnership.

EXAMINATION QUESTION.

Grey and Green amalgamated their businesses on January 1, their Balance Sheets being as follows:—

G. GREY.

LIABILITIES.	£	ASSETS.	£
Creditors	500	Plant	5,000
Bank Overdraft	250	Debtors	1,000
Capital	7,250	Stock	2,000
	£8,000		£8,000

G. GREEN.

LIABILITIES.	£	ASSETS.	£
Creditors	400	Plant	500
Capital	1,935	Debtors	700
		Stock	300
		Cash	835
	£2,335		£2,335

(*a*) Prepare opening Balance Sheet for the partnership having regard to the following adjustments: Grey to be credited with goodwill, £3,000; Green to be credited with goodwill, £500; the value of Grey's plant to be reduced by 10% and his stock by 5%; the overdraft is paid off; a Provision Account of 5% on all debtors to be raised.

(*b*) Show their Capital Accounts at June 30, the net profit for the half-year having been £4,000. Allow 5% interest on capital, and divide the profit as to two-thirds to Grey and one-third to Green.

Solution.

G. GREY'S BOOKS.

JOURNAL.

			DR.			CR.		
			£	s.	d.	£	s.	d.
19... Jan. 1	Capital Account	Dr.	650	0	0			
	To Plant Account (Depreciation) . . .					500	0	0
	,, Stock (Depreciation)					100	0	0
	,, Sundry Debtors (Provision)					50	0	0
	Being decrease in the valuation of these assets.							
,, 1	Goodwill Account	Dr.	3,000	0	0			
	To Capital Account					3,000	0	0
	Being agreed value of goodwill.							

G. Grey.

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.		£	s.	d.
Capital Account :—					Goodwill	3,000	0	0
Balance . . .	£7,250				Plant	4,500	0	0
Goodwill . .	3,000				Debtors	950	0	0
Overdraft paid off .	250				Stock	1,900	0	0
	10,500							
Less Loss on Revaluations	650	9,850	0	0				
Creditors		500	0	0				
		£10,350	0	0		£10,350	0	0

Note.—It is assumed that Grey paid off the overdraft out of private funds, as there is no cash balance.

G. GREEN'S BOOKS.

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
19... Jan. 1	Goodwill Account . . . . Dr. To Capital Account . . . . Being the agreed value of this asset.	500	0	0	500	0	0
" 1	Capital Account . . . . Dr. To Sundry Debtors . . . . Being reserve of 5% on these debts.	35	0	0	35	0	0

G. Green.

BALANCE SHEET, JANUARY, 1 19...

		£	s.	d.		£	s.	d.
Capital Account: —					Goodwill	500	0	0
Balance . . .	£1,935				Plant	500	0	0
Goodwill . .	500				Debtors	665	0	0
	2,435				Stock	300	0	0
Less Provision for Bad Debts	35	2,400	0	0	Cash	835	0	0
Creditors		400	0	0				
		£2,800	0	0		£2,800	0	0

Grey & Green.

BALANCE SHEET, JANUARY 1, 19...

(UPON AMALGAMATION.)

		£	s.	d.		£	s.	d.
Capital:—					Goodwill	3,500	0	0
G. Grey . . .	£9,850				Plant	5,000	0	0
G. Green . . .	2,400				Stock	2,200	0	0
		12,250	0	0	Debtors	1,615	0	0
Creditors		900	0	0	Cash	835	0	0
		£13,150	0	0		£13,150	0	0

Grey & Green.

BALANCE SHEET, JUNE 30, 19...

(CAPITAL AND CURRENT ACCOUNTS ONLY.)

				£	s.	d.		£	s.	d.
Capital Accounts:—										
G. Grey . .	£9,850	0	0							
G. Green .	2,400	0	0							
				12,250	0	0				
Current Accounts:—										
G. Grey—										
Interest on Capital (6 months)	246	5	0							
⅔ Profit .	2,462	10	0							
				2,708	15	0				
G. Green—										
Interest on Capital (6 months)	60	0	0							
⅓ Profit .	1,231	5	0							
				1,291	5	0				

Annuities and Partnership Accounts.—Some partnership deeds provide that on the death of a partner an annuity of agreed amount shall be paid for a fixed term to the deceased partner's representatives in lieu of a share of the goodwill arrived at in the manner described above. The usual practice in circumstances of this sort is to charge the annuity against the current Profit and Loss Account as an annual expense. But there is no objection, as an alternative method, to debiting the annual payments to goodwill, provided that that account is kept within reasonable bounds.

Dissolution.—Dissolution of partnership may result from several causes, viz. the death, bankruptcy, or lunacy of a partner; the expiration of the partnership term; the termination of the undertaking for which the partnership was formed; inability of the partners to work together in harmony, etc. It has already been stated that upon dissolution the partnership assets are applied as follows: first, in payment of debts due to outside creditors; secondly, in repayment of loans from partners; thirdly, in repayment of partners' capital; and lastly, in the distribution of the surplus, if any, amongst the partners in the proportions in which they share profits. If the assets realise less than the amount necessary to discharge the first three sets of liabilities, it is clear that there is a deficiency, which must be apportioned so that the rights of the partners as between themselves may be adjusted equitably.

Students sometimes make the mistake of assuming that partners are entitled to share the *assets* of the firm in the same proportions in which they share *profits*, and proceed to solve a dissolution problem on that basis. That, of course, is a serious error. On dissolution, the share of each partner in the assets is fixed by the amount standing to his credit on Capital and Current Account, any profit or loss on dissolution having first been apportioned in the proportion in which the partners share trading profits.

Illustration.

BALANCE SHEET.

(ON COMPLETION OF WINDING UP.)

		£	s.	d.		£	s.	d.
Capital:—					Cash at Bank (after paying all liabilities)	11,146	0	0
A. B.	£5,000							
C. D.	4,000							
		9,000	0	0				
Current Accounts:—								
A. B.	1,926							
C. D.	220							
		2,146	0	0				
		£11,146	0	0		£11,146	0	0

A. B. and C. D. are equal partners, but they are not entitled to share the assets of the firm, *i.e.* Cash £11,146, equally. A. B. is entitled to be paid his capital, £5,000, plus his Current Account, £1,926, *i.e.* £6,926; and C. D. is entitled to £4,220.

Section 44 (*a*) of the *Partnership Act*, 1890, provides that in settling accounts between partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed: "Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits." By this clause, therefore, any losses there may be must first be charged against the partners' undrawn profits (*i.e.* Current Accounts), next against their Capital Accounts, and finally, should any deficiency then remain, it must be made good by actual contribution in cash.

The book-keeping entries recording a dissolution follow closely those necessary in company liquidation. A Realisation Account is opened in which must be collected the profits or losses arising from the disposal of the assets, or the settlement of the liabilities. The expenses arising from the dissolution are debited to the same account, which then shows the net profit resulting from the winding up of the business. The resulting profit, or loss, is transferred to the partners' Current Accounts, in the same proportion in which trading profits and losses are shared. The balance of cash available will then exactly suffice to discharge the credit balances of the partners' Capital and Current Accounts. Should the Capital Account of any partner show a debit balance, he must pay in the amount necessary to make good the deficiency, since, in effect, he has overdrawn his Capital Account. It is important to remember that, in the absence of special agreement, no partner can claim interest on capital or partnership salary beyond the date of dissolution, however long the winding-up procedure may take. In the author's experience, some examination candidates treat the balance of cash available upon dissolution as a profit, and proceed to divide it as such. It is the *profit or the loss* on realisation which must be apportioned, and not the amount finally shown as available. If the dissolution accounts are correct, the amount shown as due on the partners' Capital Accounts will be exactly discharged by the balance of cash available as shown by the cash book.

The following illustrations deal with some of the more common circumstances met with in partnership dissolutions.

Cessation of Business and Sale of Assets.

Illustration.—George and Hugh Dickson, trading as Dickson Brothers, are equal partners. They agree to sell their business to Chatenays, Ltd., as on December 31, 19... The purchase price is agreed at £65,000, payable in cash. The liabilities are to be paid by the purchasers, and the assets are to be taken over by the company at their book values. This illustration presents a dissolution problem in its simplest form. After final adjustments, the Balance Sheet of the firm was as follows:—

Dickson Brothers.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Freehold Warehouse	28,562	0	0
G. Dickson	£30,000				Machinery and Plant	14,485	0	0
H. Dickson	25,000				Motor Lorries	2,876	0	0
		55,000	0	0	Stock	9,440	0	0
Loan and Interest, G. Dickson		5,250	0	0	Sundry Debtors	13,212	0	0
Sundry Creditors		10,286	0	0	Cash at Bank	1,961	0	0
		£70,536	0	0		£70,536	0	0

JOURNAL.

			Dr.			Cr.		
19...			£	s.	d.	£	s.	d.
Dec. 31	Realisation Account . . . . . . Dr.	21	70,536	0	0			
	To Sundry Assets :—							
	Freehold Property	2				28,562	0	0
	Machinery and Plant	4				14,485	0	0
	Motor Lorries.	6				2,876	0	0
	Stock	8				9,440	0	0
	Sundry Debtors	10				13,212	0	0
	Cash at Bank	12				1,961	0	0
	Being assets sold to Chatenays, Ltd., at the above prices.							
„ 31	Sundries :— Dr.							
	Sundry Creditors	13	10,286	0	0			
	Loan (G. Dickson)	15	5,250	0	0			
	To Realisation Account	22				15,536	0	0
	Being liabilities of Dickson Brothers now paid off.							
„ 31	Chatenays, Ltd. . . . . Dr.	24	65,000	0	0			
	To Realisation Account	22				65,000	0	0
	Being agreed purchase price of the business.							
„ 31	Realisation Account . . . . . . Dr.	21	10,000	0	0			
	To G. Dickson (Capital Account)	18				5,000	0	0
	„ H. Dickson (Capital Account).	20				5,000	0	0
	Being division of the profit on the sale of the business.							

LEDGER.

1 **Freehold Property.** 2

Dr. Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance . .	√	28,562	0	0	Dec. 31	By Realisation Account . .	14	28,562	0	0

3 **Machinery and Plant.** 4

Dr. Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance . .	√	14,485	0	0	Dec. 31	By Realisation Account . .	14	14,485	0	0

5 **Motor Lorries.** 6

Dr. Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance . .	√	2,876	0	0	Dec. 31	By Realisation Account . .	14	2,876	0	0

7 **Stock.** 8

Dr. Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance . .	√	9,440	0	0	Dec. 31	By Realisation Account . .	14	9,440	0	0

LEDGER—*continued.*

9 Dr.

Sundry Debtors.

10 Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance	√	13,212	0	0	Dec. 31	By Realisation Account	14	13,212	0	0

11 Dr.

CASH BOOK.

12 Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance	√	1,961	0	0	Dec. 31	By Realisation Account	14	1,961	0	0
„ 31	„ Cash. Chatenays, Ltd., Purchase Price of Business	24	65,000	0	0	„ 31	„ Cash. G. Dickson	18	35,000	0	0
						„ 31	„ Cash. H. Dickson	20	30,000	0	0
			66,961	0	0				66,961	0	0

13 Dr.

Sundry Creditors.

14 Cr.

19...		J.	£	s.	d.	19...			£	s.	d.
Dec. 31	To Realisation Account	14	10,286	0	0	Dec. 31	By Balance	√	10,286	0	0

15 Dr.

G. Dickson. Loan Account.

16 Cr.

19...		J.	£	s.	d.	19...			£	s.	d.
Dec. 31	To Realisation Account	14	5,250	0	0	Dec. 31	By Balance	√	5,250	0	0

17 Dr.

G. Dickson. Capital Account.

18 Cr.

19...		C.B.	£	s.	d.	19...			£	s.	d.
Dec. 31	To Cash	12	35,000	0	0	Dec. 31	By Balance	√	30,000	0	0
						„ 31	„ Share of Profit on Sale of Business	14	5,000	0	0
			£35,000	0	0				£35,000	0	0

19 Dr.

H. Dickson. Capital Account.

20 Cr.

19...		C.B.	£	s.	d.	19...			£	s.	d.
Dec. 31	To Cash	12	30,000	0	0	Dec. 31	By Balance	√	25,000	0	0
						„ 31	„ Share of Profit on Sale of Business	J. 14	5,000	0	0
			£30,000	0	0				£30,000	0	0

LEDGER—*continued.*

21 REALISATION ACCOUNT. 22

Dr. Cr.

		J.	£	s.	d.			J.	£	s.	d.
19...						19...					
Dec. 31	To Sundry Assets sold to Chatenays, Ltd. .	14	70,536	0	0	Dec. 31	By Sundry Liabilities now paid off . .	14	15,536	0	0
,, 31	,, Balance carried down, being profit on the sale . .	√	10,000	0	0	,, 31	,, Chatenays, Ltd., purchase price of business .	14	65,000	0	0
			£80,536	0	0				£80,536	0	0
19...		J.				19...					
Dec. 31	To G. Dickson .	14	5,000	0	0	Dec. 31	By Balance brought down . .	√	10,000	0	0
,, 31	,, H. Dickson .	14	5,000	0	0						
			£10,000	0	0				£10,000	0	0

23 CHATENAYS, LTD. 24

Dr. Cr.

		J.	£	s.	d.			C.B.	£	s.	d.
19...						19...					
Dec. 31	To Realisation Account, Purchase Price of Business . .	14	65,000	0	0	Dec. 31	By Cash . .	11	65,000	0	0
			£65,000	0	0				£65,000	0	0

Profit on Dissolution.—Where the dissolution results in a profit, the Realisation Account takes the form of a Profit and Loss Account, although, of course, in place of the usual revenue charges, it deals with the discharge of liabilities and the realisation of assets. The total assets and liabilities may be treated as in the illustration above, or the sale proceeds of the assets may be credited to the relative accounts, and the balance of profit or loss be transferred to the Realisation Account. For examination purposes it is preferable to transfer all the assets, by means of a journal entry, to the debit of the Realisation Account, and to credit the sale proceeds to the same account, thus arriving at the final balance available for distribution between the partners.

Procedure for Dissolution Problems.—(1) Open ledger accounts: (*a*) for each asset; (*b*) sundry creditors; (*c*) any other liabilities; (*d*) partners' Capital and Loan Accounts, where not already in existence. (2) Close all the asset accounts, except cash, by transfer to the Realisation Account. (3) Debit cash with the proceeds of the sale of the assets, and credit Realisation Account. (4) Credit cash with liabilities and loans, when paid, and debit the relative liability accounts. (5) Credit cash with the expenses of dissolution, and debit Realisation Account. (6) Debit partners' Capital Accounts with any assets taken over by them at the price agreed, and credit Realisation Account. (7) Credit or debit the partners' Capital Accounts with their proportion of the profit or loss upon realisation as the case may be. (8) If any partner's Capital Account is in debit, assume that the deficiency is made good, and debit cash and credit the relative Capital Account. (9) After the procedure indicated above, the cash balance available should exactly equal the aggregate balances shown by the Capital Accounts of the partners.

In practice, Debtors and Creditors are not taken over in order to save Transfer Duties, etc.

Illustration.—G. McArthur and C. Testout agree to dissolve partnership and retire from business as on December 31, 19... Profits and losses are shared as to two-thirds and one-third respectively. The Balance Sheet of the firm, as on the date of retirement, was as follows:—

McArthur & Testout.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Freehold Factory	18,485	0	0
McArthur	£30,000				Machinery and Plant	9,875	0	0
Testout	10,000				Sundry Debtors	7,546	0	0
		40,000	0	0	Stock	9,462	0	0
Loan Account		3,000	0	0	Patents	500	0	0
Sundry Creditors		3,652	0	0	Cash at Bank	784	0	0
		£46,652	0	0		£46,652	0	0

The results of the realisation were as follows: Freehold Factory, £26,450; Machinery and Plant, £8,924; Sundry Debtors, £7,395; Stock, £9,886; Patents, nil. The dissolution expenses amounted to £200. McArthur took over a motor-car (included in Machinery and Plant at £250) at an agreed price of £220. The accounts necessary to record the dissolution are as follows:—

36 JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Realisation Account . . . . . . Dr.	21	45,868	0	0			
	To Sundry Assets:—							
	Freehold Factory	10				18,485	0	0
	Machinery and Plant	12				9,875	0	0
	Sundry Debtors	14				7,546	0	0
	Stock	16				9,462	0	0
	Patents	18				500	0	0
	Being transfer of these assets upon dissolution.							
" 31	Cash . . . . Dr.	C.B. 19	52,655	0	0			
	To Realisation Account	22				52,655	0	0
	Being proceeds of sale of the above assets.							
" 31	Realisation Account . . . . . . Dr.	21	200	0	0			
	To Cash	C.B. 20				200	0	0
	Being expenses of dissolution.							
" 31	G. McArthur, Capital Account . . . Dr.	1	220	0	0			
	To Realisation Account	22				220	0	0
	Being agreed value of motor taken over.							
" 31	Realisation Account . . . . . . Dr.	21	6,807	0	0			
	To G. McArthur (Capital Account)	2				4,538	0	0
	" C. Testout (Capital Account)	4				2,269	0	0
	Being profit on realisation now transferred.							

LEDGER.

1 **G. McArthur. Capital Account.** 2

Dr. Cr.

19...		J.	£	s.	d.	19...			£	s.	d.
Dec. 31	To Motor . .	36	220	0	0	Dec. 31	By Balance . .	√	30,000	0	0
„ 31	„ Balance carried down . .	√	34,318	0	0	„ 31	„ Realisation Account . .	J. 36	4,538	0	0
			£34,538	0	0				£34,538	0	0
19...		C.B.				19...					
Dec. 31	To Cash . .	20	34,318	0	0	Dec. 31	By Balance brought down . .	√	34,318	0	0

3 **C. Testout. Capital Account.** 4

Dr. Cr.

19...			£	s.	d.	19...			£	s.	d.
Dec. 31	To Balance carried down . .	√	12,269	0	0	Dec. 31	By Balance . .	√	10,000	0	0
						„ 31	„ Realisation Account . .	36	2,269	0	0
			£12,269	0	0				£12,269	0	0
19...		C.B.				19...					
Dec. 31	To Cash . .	20	12,269	0	0	Dec. 31	By Balance brought down . .	√	12,269	0	0

5 **Loan Account.** 6

Dr. Cr.

19...		C.B.	£	s.	d.	19...			£	s.	d.
Dec. 31	To Cash . .	20	3,000	0	0	Dec. 31	By Balance . .	√	3,000	0	0

7 **Sundry Creditors.** 8

Dr. Cr.

19...		C.B.	£	s.	d.	19...			£	s.	d.
Dec. 31	To Cash . .	20	3,652	0	0	Dec. 13	By Balance . .	√	3,652	0	0

9 **Freehold Factory.** 10

Dr. Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance . .	√	18,485	0	0	Dec. 31	By Realisation Account . .	36	18,485	0	0

11 **Machinery and Plant.** 12

Dr. Cr.

LEDGER—*continued.*

SUNDRY DEBTORS.

14

)R. Cr.

			£	s.	d.	19...		J.	£	s.	d.
)...											
:. 31	To Balance . .	√	7,546	0	0	Dec. 31	By Realisation Account . .	36	7,546	0	0

STOCK.

16

)R. Cr.

			£	s.	d.	19...		J.	£	s.	d.
)...											
:. 31	To Balance . .	√	9,462	0	0	Dec. 31	By Realisation Account . .	36	9,462	0	0

PATENTS.

18

)R. Cr.

			£	s.	d.	19...		J.	£	s.	d.
)...											
:. 31	To Balance . .	√	500	0	0	Dec. 31	By Realisation Account . .	36	500	0	0

REALISATION ACCOUNT.

20

)R. Cr.

		J.	£	s.	d.	19...		J.	£	s.	d.
9...											
:. 31	To Sundry Assets .	36	45,868	0	0	Dec. 31	By Cash (Proceeds Sale of Assets)	36	52,655	0	0
31	,, Cash (Dissolution Expenses) .	36	200	0	0	,, 31	,, G. McArthur (Motor) .	36	220	0	0
31	,, Balance carried down . .	√	6,807	0	0						
			£52,875	0	0				£52,875	0	0
9...						19...					
:. 31	To G. McArthur .	36	4,538	0	0	Dec. 31	By Balance brought down . .	√	6,807	0	0
31	,, C. Testout .	36	2,269	0	0						
			£6,807	0	0				£6,807	0	0

CASH BOOK.

22

)R. Cr.

			£	s.	d.	19...		J.	£	s.	d.
9...											
:. 31	To Balance . .	√	784	0	0	Dec. 31	By Dissolution Expenses .	36	200	0	0
31	,, Cash, Proceeds Sale of Assets .	J. 36	52,655	0	0	,, 31	,, Sundry Creditors	7	3,652	0	0
						,, 31	,, Loan . .	5	3,000	0	0
						,, 31	,, Cash—				
							G. McArthur .	1	34,318	0	0
							C. Testout .	3	12,269	0	0
			£53,439	0	0				£53,439	0	0

REALISATION ACCOUNT.

(Alternative Method.)

Dr.		£	s.	d.			£	s.	d. Cr.
To Transfer from Sundry Asset Accounts (loss on realisation):—					By Transfer from Sundry Asset Accounts (profit on sale):—				
Machinery and Plant	£701				Freehold Factory	£7,965			
Motor Car . .	30				Stock . .	424	8,389	0	0
Sundry Debtors .	151								
Patents . . .	500	1,382	0	0					
" Cash. Expenses of dissolution .		200	0	0					
" Balance carried down . .		6,807	0	0					
		£8,389	0	0			£8,389	0	0
To G. McArthur, Share of Profit .		4,538	0	0	By Balance brought down . .		6,807	0	0
" C. Testout, Share of Profit .		2,269	0	0					
		£6,807	0	0			£6,807	0	0

CASH BOOK.

Dr. 19...		£	s.	d.	19...		£	s.	d. Cr.
Dec. 31	To Balance . .	784	0	0	Dec. 31	By Dissolution Expenses .	200	0	0
" 31	" Cash. Proceeds Sale of Sundry Assets:				" 31	" Sundry Creditors .	3,652	0	0
	Freehold Factory	26,450	0	0	" 31	" Loan . . .	3,000	0	0
	Machinery and Plant .	8,924	0	0	" 31	" Cash. G. McArthur	34,318	0	0
	Sundry Debtors .	7,395	0	0	" 31	" Cash. C. Testout.	12,269	0	0
	Stock . .	9,886	0	0					
		£53,439	0	0			£53,439	0	0

EXAMINATION QUESTION.

X, Y, and Z, are partners and share profits as follows: X, ten twenty-fourths; Y, nine twenty-fourths; Z, five twenty-fourths.

X retired, as on December 31, 19..., at which date the Balance Sheet of the firm was as stated below:—

BALANCE SHEET, DECEMBER 31, 19...

		£		£
Capital—			Goodwill	10,000
X . . .	£10,000		Machinery . . .	8,760
Y . . .	7,000		Sundry Assets . . .	10,354
Z . . .	5,000	22,000		
Current Accounts—				
X . . .	£1,084			
Y . . .	327			
Z . . .	871	2,282		
Creditors . . .		4,832		
		£29,114		£29,114

Under the partnership agreement, all assets and liabilities were to be taken at book values, with the exception of: (*a*) Goodwill, which was to be valued at three times the average profits of the three years preceding the retirement, and (*b*) Machinery, which was to be re-valued by an independent valuer. The profits of the three years prior to the retirement were: First year, £3,742; second year,

£5,641; third year, £1,472. The expert valuation of the machinery was £9,875. Prepare accounts showing the amount due to X on his retirement. (*Royal Society Arts.*)

Solution.

JOURNAL.

	Dr. £	s.	d.	Cr. £	s.	d.
Goodwill Account . . . . Dr.	855	0	0			
To Realisation Account				855	0	0
Being increase in the valuation of goodwill, *i.e.* three times the average profits = £10,855.						
Machinery Account. . . . . . . Dr.	1,115	0	0			
To Realisation Account				1,115	0	0
Being increase in the valuation of this asset.						
Realisation Account . . . . . . Dr.	1,970	0	0			
To X. Capital Account				820	16	8
,, Y. Capital Account				738	15	0
,, Z. Capital Account				410	8	4
Being the partners' shares of the profit on the revaluations.						

X, Y & Z.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Goodwill	10,855	0	0
Y . . .	£7,738 15 0				Machinery	9,875	0	0
Z . . .	5,410 8 4	13,149	3	4	Sundry Assets	10,354	0	0
Current Accounts:—								
Y . . .	327 0 0							
Z . . .	871 0 0	1,198	0	0				
X. Balance of Capital Account . .	10,820 16 8							
X. Balance of Current Account . .	1,084 0 0	11,904	16	8				
Creditors		4,832	0	0				
		£31,084	0	0		£31,084	0	0

Dissolution and Division of Assets.—In some cases, on the retirement of a partner, the remaining partners decide to separate and dissolve the old firm, one or more of them agreeing to take over the assets upon agreed terms.

Illustration.—Deeds, Tape, and Parchment are in partnership as solicitors. Profits are shared in the proportions respectively of one-half, one-fourth, and one-fourth. Deeds retired on December 31, 19..., and Tape and Parchment decided to practise separately—Tape taking over the general, and Parchment the parliamentary practice. The Balance Sheet on the date of dissolution was as follows:—

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.			£	s.	d.
Capital:—					Lease of Offices		1,250	0	0
Deeds . . .	£10,000				Furniture and Fittings . .		875	0	0
Tape . . .	8,000				Sundry Debtors:—				
Parchment . .	6,800				General . .	£9,950			
		24,800	0	0	Parliamentary .	8,420			
Creditors		5,378	0	0			18,370	0	0
					Cash at Bank		9,683	0	0
		£30,178	0	0			£30,178	0	0

The agreed terms of dissolution were that Deeds was to be credited with £6,000 as representing the value of his share of the goodwill, and that this sum was to be provided in equal shares by Tape and Parchment. Tape was to take over the lease of the offices at £1,000, the Furniture and Fittings at £750, and the general debtors at £9,500. Parchment was to take over the parliamentary debtors at £8,000. Discounts amounting to £23 were secured on payment of the creditors. The dissolution expenses were £250.

CASH BOOK.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Balance . .	9,683	0	0	19... Dec. 31	By Creditors . .	5,355	0	0
„ 31	„ Cash, Tape . .	6,618	0	0	„ 31	„ Expenses of Dissolution . .	250	0	0
„ 31	„ Cash, Parchment .	4,568	0	0	„ 31	„ Cash, Deeds, Balance of Capital Account . .	15,264	0	0
		£20,869	0	0			£20,869	0	0

REALISATION ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Loss on Realisation:—				19... Dec. 31	By Discount on Sundry Creditors . .	23	0	0
	Lease of Offices .	250	0	0	„ 31	„ Balance carried down . .	1,472	0	0
	Furniture and Fittings . . .	125	0	0					
	General Debtors .	450	0	0					
	Parliamentary Debtors . .	420	0	0					
„ 13	„ Expenses of Dissolution . .	250	0	0					
		£1,495	0	0			£1,495	0	0
19... Dec. 31	To Balance brought down . .	1,472	0	0	19... Dec. 31	By Deeds, ½ Share of Loss . .	736	0	0
					„ 31	„ Tape, ¼ Share of Loss . .	368	0	0
					„ 31	Parchment, ¼ Share of Loss .	368	0	0
		£1,472	0	0			£1,472	0	0

DEEDS. CAPITAL ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Share of Loss on Realisation .	736	0	0	19... Dec. 31	By Balance . .	10,000	0	0
„ 31	„ Balance carried down . .	15,264	0	0	„ 31	„ Goodwill . .	6,000	0	0
		£16,000	0	0			£16,000	0	0
19... Dec. 31	To Cash . . .	15,264	0	0	19... Dec. 31	By Balance brought down . .	15,264	0	0
		£15,264	0	0			£15,264	0	0

TAPE. CAPITAL ACCOUNT.

Dr.		£	s.	d.		Cr.	£	s.	d.
19... Dec. 31	To Share of Loss on Realisation .	368	0	0	19... Dec. 31	By Balance . .	8,000	0	0
,, 31	,, Half Share of Deed's Goodwill .	3,000	0	0	,, 31	,, Balance carried down . .	6,618	0	0
,, 31	,, Lease of Offices .	1,000	0	0					
,, 31	,, Furniture and Fittings . .	750	0	0					
31	,, General Debtors .	9,500	0	0					
		£14,618	0	0			£14,618	0	0
19... Dec. 31	To Balance brought down . .	6,618	0	0	19... Dec. 31	By Cash . . .	6,618	0	0
		£6,618	0	0			£6,618	0	0

PARCHMENT. CAPITAL ACCOUNT.

Dr.		£	s.	d.		Cr.	£	s.	d.
19... Dec. 31	To Share of Loss on Realisation .	368	0	0	19... Dec. 31	By Balance . .	6,800	0	0
,, 31	,, Half Share of Deed's Goodwill	3,000	0	0	,, 31	,, Balance carried down . .	4,568	0	0
,, 31	,, Parliamentary Debtors . .	8,000	0	0					
		£11,368	0	0			£11,368	0	0
19... Dec. 31	To Balance brought down . .	4,568	0	0	19... Dec. 31	By Cash .	4,568	0	0
		£4,568	0	0			£4,568	0	0

Note.—The student will realise that for this arrangement to be fair the Goodwill of the two branches of the practice must be substantially equal in value.

Distribution of Assets in Specie.—Where the partners cannot agree upon the value to be assigned to certain assets which cannot readily or conveniently be realised, the book value should, in the absence of agreement, be transferred to the debit of the partner's Capital Accounts in the proportion in which they share profits or losses.

Illustration.—A and B have capitals of £900 and £600, and share profits as to one-fourth and three-fourths, respectively. The assets include 400 shares of doubtful value, which appear in the books at cost, *i.e.* £300. They ask your advice as to the proper treatment of this asset upon dissolution, as they are unable to agree. State your proposals.

Answer.—Assuming each share to be of the same class, the asset account should be closed off by transferring £75 to the debit of A's Capital Account, and £225 to the debit of B's Capital Account, the shares being transferred into the names of the individual partners, *i.e.* 100 to A and 300 to B, or being held for them in that proportion. By such means the holding of each partner becomes rateable to his interest in the shares, for it is then immaterial whether they are worth more or less than the book value, or whether a profit or loss ultimately results.

Dissolution and Revaluation of Assets.

Illustration.—H. Dickson, J. B. Clarke, and G. Macdonald were partners, sharing profits in the proportions one-half, one-third, and one-sixth respectively. The Balance Sheet of the firm at December 31, 19..., was as follows:—

Dickson, Clarke & Macdonald.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:					Freehold Factory	10,000	0	0
H. Dickson	£12,000				Machinery and Plant	5,741	0	0
J. B. Clarke	7,000				Loose Tools	744	0	0
G. Macdonald	3,500				Motor Vans	3,462	0	0
		22,500	0	0	Stock	4,878	0	0
Sundry Creditors		1,440	0	0	Sundry Debtors	3,641	0	0
Bills Payable		800	0	0	Cash at Bank	2,274	0	0
Loan (secured by mortgage on Freehold Factory)		6,000	0	0				
		£30,740	0	0		£30,740	0	0

Dickson retired as on January 1 following the above Balance Sheet. The business was taken over by Clarke and Macdonald on the following terms:—

(*a*) The assets were to be revalued as follows: Freehold Factory, £12,000; Machinery and Plant was to be depreciated by 20%, and Loose Tools by 33⅓%; Motor Vans, £2,200; Stock, £5,000. Provision for bad debts was agreed at £300.

(*b*) The liabilities were taken over at the Balance Sheet values, and discount amounting to £102 was secured when paying the creditors. One quarter's interest on the Mortgage at 5% had been omitted from the Balance Sheet.

(*c*) Goodwill was to be valued at £8,000.

(*d*) Of the amount due to Dickson on retirement, £5,000 was to be left in the business as a loan at 5%, and the balance was to be paid out over a term of ten years in equal instalments beginning June 30 next after the retirement.

(*e*) Clarke and Macdonald were to pay the expenses connected with the retirement, and these amounted to £100.

Prepare (1) the Journal entries, (2) the Realisation Account and other Ledger accounts recording the above particulars in the books of the old firm as on January 1, 19..., assuming that the transactions had been completed on that date. Assume also that the Sundry Creditors were paid off in cash, and that the Mortgage on the Factory and the Bills Payable remain on the books as shown in the above Balance Sheet.

16

JOURNAL.

				Dr.			Cr.		
				£	s.	d.	£	s.	d.
19...									
Dec. 31	Sundries	Dr.							
	To Realisation Account		2				2,122	0	0
	Freehold Factory		11	2,000	0	0			
	Stock		15	122	0	0			
	Being appreciation of these assets.								
,, 31	Realisation Account	Dr.	1	2,958	4	0			
	To Sundries:—								
	Plant and Machinery		14				1,148	4	0
	Loose Tools		18				248	0	0
	Motor Vans		20				1,262	0	0
	Sundry Debtors (Provision)		22				300	0	0
	Being depreciation of these assets and provision for bad debts.								
,, 31	Goodwill	Dr.	31	8,000	0	0			
	To Realisation Account		2				8,000	0	0
	Being agreed value of this asset.								
,, 31	Realisation Account	Dr.	1	75	0	0			
	To Mortage Interest		34				75	0	0
	Being one quarter's interest at 5% per annum on £6,000 accrued due.								
,, 31	Discount Account	Dr.	27	102	0	0			
	To J. B. Clarke, Capital Account		10				68	0	0
	,, G. Macdonald, Capital Account		4				34	0	0
	Being profit (discount) on discharge of creditors.								

LEDGER.

REALISATION ACCOUNT.

1 Dr. — Cr. 2

		J.	£	s.	d.	£	s.	d.			J.	£	s.	d.	£	s.	d.
19... Dec. 31	To Depreciation :—								19... Dec. 31	By Freehold Property (Appreciation)	16				2,000	0	0
,, 31	Plant and Machinery	16	1,148	4	0				,, 31	,, Stock (Appreciation)	16				122	0	0
,, 31	Loose Tools		248	0	0				,, 31	,, Goodwill	16				8,000	0	0
,, 31	Motor Vans		1,262	0	0												
,, 31	Sundry Debtors		300	0	0	2,958	4	0									
,, 31	,, Mortgage Interest accrued	16				75	0	0									
,, 31	,, Balance carried down	√				7,088	16	0									
						£10,122	0	0							£10,122	0	0
19... Dec. 31	To H. Dickson, Capital Account	8				3,544	8	0	19... Dec. 31	By Balance brought down	√				7,088	16	0
,, 31	,, J. B. Clarke, Capital Account	10				2,362	18	8									
,, 31	,, G. Macdonald, Capital Account	4				1,181	9	4									
						£7,088	16	0							£7,088	16	0

G. MACDONALD. CAPITAL ACCOUNT.

3 Dr. — Cr. 4

		C.B.	£	s.	d.				£	s.	d.
19... Dec. 31	To Share of Cost of Realisation	30	33	6	8	19... Dec. 31	By Balance	√	3,500	0	0
,, 31	,, Balance carried down	√	4,648	2	8	,, 31	,, Share of Profit on Realisation	1	1,181	9	4
			£4,681	9	4				£4,681	9	4
19... Jan. 1	To Balance carried down	√	4,682	2	8	19... Jan. 1	By Balance brought down	√	4,648	2	8
						,, 1	,, Profit on discharge of Creditors	J.16	34	0	0
			£4,682	2	8				£4,682	2	8
						Jan. 1	By Balance brought down	7	4,682	2	8

LEDGER—*continued.*

HUGH DICKSON. LOAN ACCOUNT

5 DR. | CR. 6

			£	s.	d.				£	s.	d.
						19... Jan. 1	By Transfer from Capital Account	7	5,000	0	0

HUGH DICKSON. CAPITAL ACCOUNT.

7 DR. | CR. 8

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance carried down	✓	15,544	8	0	19... Dec. 31	By Balance	✓	12,000	0	0
						,, 31	,, Share of Profit on Realisation	1	3,544	8	0
			£15,544	8	0				£15,544	8	0
19... Jan. 1	To Transfer to Loan Account	6	5,000	0	0	19... Dec. 31	By Balance brought down	✓	15,544	8	0
,, 1	,, Balance carried down	✓	10,544	8	0						
			£15,544	8	0				£15,544	8	0
						19... Jan. 1	By Balance brought down	✓	10,544	8	0

J. B. CLARKE. CAPITAL ACCOUNT.

9 DR. | CR. 10

			£	s.	d.				£	s.	d.
19... Dec. 31	To Share of Cost of Realisation	C.B. 30	66	13	4	19... Dec. 31	By Balance	✓	7,000	0	0
,, 31	,, Balance carried down	✓	9,296	5	4	,, 31	,, Share of Profit on Realisation	1	2,362	18	8
			£9,362	18	8				£9,362	18	8
19... Jan. 1	To Balance carried down	✓	9,364	5	4	19... Jan. 1	By Balance brought down	✓	9,296	5	4
						,, 1	,, Profit on discharge of Creditors	J.16	68	0	0
			£9,364	5	4				£9,364	5	4
						19... Jan. 1	By Balance brought down	✓	9,364	5	4

LEDGER—*continued.*

FREEHOLD FACTORY.

11 DR. | 12 CR.

			£	s.	d.				£	s.	d.
19...						19...					
Dec. 31	To Balance . .	√	10,000	0	0	Dec. 31	By Balance carried down . .	√	12,000	0	0
„ 31	„ Realisation Account . .	J. 16	2,000	0	0						
			£12,000	0	0				£12,000	0	0
19...											
Jan. 1	To Balance brought down . .		12,000	0	0						

MACHINERY AND PLANT.

13 DR. | 14 CR.

			£	s.	d.			J.	£	s.	d
19...						19...					
Dec. 31	To Balance . .	√	5,741	0	0	Dec. 31	By Realisation Account .	16	1,148	4	0
						„ 31	„ Balance carried down .	√	4,592	16	0
			£5,741	0	0				£5,741	0	
19...											
Jan. 1	To Balance brought down . .	√	4,592	16	0						

STOCK.

15 DR. | 1 CR.

			£	s.	d.				£	s.	
19...						19...					
Dec. 31	To Balance . .	√	4,878	0	0	Dec. 31	By Balance carried down . .	√	5,000	0	
„ 31	„ Realisation Account . .	J. 16	122	0	0						
			£5,000	0	0				£5,000	0	
19...											
Jan. 1	To Balance brought down . .	√	5,000	0	0						

LOOSE TOOLS.

17 DR. | 1 CR.

			£	s.	d.			J.	£	s.	
19...						19...					
Dec. 31	To Balance . .	√	744	0	0	Dec. 31	By Realisation Account .	16	248	0	
						„ 31	„ Balance carried down .	√	496	0	
			£744	0	0				£744	0	
19...											
Jan. 1	To Balance brought down . .	√	496	0	0						

LEDGER—*continued.*

MOTOR VANS.

19 Dr. — Cr. 20

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	√	3,462	0	0	19... Dec. 31	By Realisation Account .	16	1,262	0	0
						" 31	" Balance carried down .	√	2,200	0	0
			£3,462	0	0				£3,462	0	0
19... Jan. 1	To Balance brought down . .	√	2,200	0	0						

SUNDRY DEBTORS.

21 Dr. — Cr. 22

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	√	3,641	0	0	19... Dec. 31	By Realisation Account .	16	300	0	0
						" 31	" Balance carried down .	√	3,341	0	0
			£3,641	0	0				£3,641	0	0
19... Jan. 1	To Balance brought down . .	√	3,341	0	0						

SUNDRY CREDITORS.

23 Dr. — Cr. 24

		C.B.	£	s.	d.				£	s.	d.
19... Dec. 31	To Cash and Discount . .	30	1,440	0	0	19... Dec. 31	By Balance .	√	1,440	0	0
			£1,440	0	0				£1,440	0	0

BILLS PAYABLE.

25 Dr. — Cr. 26

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Balance .	√	800	0	0

DISCOUNT ACCOUNT.

27 Dr. — Cr. 28

			£	s.	d.			C.B.	£	s.	d.
19... Dec. 31	To J. B. Clarke, Capital Account		68	0	0	19... Dec. 31	By Sundries .	30	102	0	0
" 31	" G. Macdonald, Capital Account		34	0	0						
		√	£102	0	0				£102	0	0

LEDGER—*continued.*

CASH BOOK.

29 Dr. | Cr. 30

			Discount.			Bank.						Discount.			Bank.		
			£	s.	d.	£	s.	d.				£	s.	d.	£	s.	d.
19... Dec. 31	To Balance	√				2,274	0	0	19... Dec. 31	By Sundry Creditors . . .	23	102	0	0	1,338	0	0
									,, 31	,, Expenses of Realisation :—							
										J. B. Clarke . £66 13 4	9						
										G. Macdonald . 33 6 8	3						
															100	0	0
									,, 31	,, Balance carried down . .	√				836	0	0
						£2,274	0	0				£102	0	0	£2,274	0	0
19... Jan. 1	To Balance brought down . .	√				836	0	0									

Goodwill.

31 Dr. | Cr. 32

			£	s.	d.				£	s.	d.
19... Dec. 31	To Realisation Account	J. 16	8,000	0	0						

Mortgage Interest.

3 Dr. | Cr. 34

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Realisation Account	J. 16	75	0	0

Clarke & Macdonald.

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.			£	s.	d.
Capital—					Goodwill		8,000	0	0
J. B. Clarke	£9,364 5 4				Freehold Factory		12,000	0	0
G. Macdonald	4,682 2 8	14,046	8	0	Machinery and Plant		4,592	16	0
					Loose Tools		496	0	0
Sundry Creditors—					Motor Vans		2,200	0	0
H. Dickson	£10,544 8 0				Stock		5,000	0	0
Bills Payable	800 0 0	11,344	8	0	Sundry Debtors	£3,641 0 0			
H. Dickson, Loan Account		5,000	0	0	*Less* Provision for Bad Debts	300 0 0	3,341	0	0
Mortgage	£6,000 0 0				Cash at Bank		836	0	0
Mortgage Interest accrued	75 0 0	6,075	0	0					
		£36,465	16	0			£36,465	16	0

Note.—Goodwill. If Clarke and Macdonald decided that they did not want a figure of Goodwill in the Balance Sheet, they could :—

(*a*) Credit Goodwill £8,000, and debit their Capital Accounts in proportion (2 and 1).

(*b*) They could have omitted it entirely from the Realisation Account, merely crediting Dickson's Capital Account with his share (£4,000) and debiting the like amount to their own Capital Accounts in proportion (2 and 1).

Dissolution. Writing Back Reserves and Revaluation.

Illustration.—X, Y, and Z own in partnership a fleet of steamers. They share profits as follows: X, one-half; Y, one-third; Z, one-sixth. X holds £40,000 of the capital, Y, £18,000, and Z, £14,000. X retired from the firm as on December 31, 19... According to the partnership deed, goodwill was to be valued on the death or retirement of a partner at an amount equal to the average of the profits of the three years preceding retirement or death. The profits for the first year, coming into average, were £14,782; for the second year there was a loss of £4,287; and for the third year a profit of £20,189. The average profits were therefore:—

	£
First year, profit	14,782
Third year, profit £20,189, less Loss on Stores (see below), £684	19,505
	34,287
Less Second year, loss	4,287
	3)30,000
Average profit	£10,000

The Balance Sheet of the firm on December 31, 19..., the date of X's retirement, was as follows:—

X, Y & Z.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Steamships (*Rose*, *Tulip*, and *Aster*)	94,656	0	0
X	£40,000				Leasehold Wharf . . .	9,684	0	0
Y	18,000				Stores, Coal, etc. . . .	8,684	0	0
Z	14,000				Lighters and Launch . .	2,178	0	0
		72,000	0	0	Sundry Debtors . . .	12,641	0	0
Current Accounts:—					Cash at Bank	5,620	0	0
X	5,872							
Y	3,242							
Z	1,874							
		10,988	0	0				
Marine Insurance Fund . .		18,250	0	0				
Provision for Bad Debts . .		1,000	0	0				
Loan from Bank . . .		12,500	0	0				
Sundry Creditors . . .		17,975	0	0				
Suspense Account . . .		750	0	0				
		£133,463	0	0		£133,463	0	0

It had been the firm's practice to underwrite a portion of their marine risks by charging an annual sum to Profit and Loss Account. It was agreed that the marine risks represented by the accumulated fund standing in the Balance Sheet had expired. It was also agreed that: (*a*) the Provision for bad debts was £350 in excess of requirements; (*b*) the Suspense Account, created to complete a claim now abandoned, should be written back. The following revaluations were also agreed; Steamships, £90,000; Leasehold Wharf, £12,742;

Stores, etc., £8,000; Lighters, etc., £2,000. Dissolution expenses were £200. The Realisation (or Revaluation) Account is as follows:—

REALISATION ACCOUNT.

Dr.							Cr.		
		£	s.	d.			£	s.	d.
19... Dec. 31	To Depreciations as agreed:—				19... Dec. 31	By Marine Insurance Fund, written back	18,250	0	0
	Steamships	4,656	0	0	,, 31	,, Suspense Account, written back	750	0	0
	Stores	684	0	0	,, 31	,, Excess provision for Bad Debts, written back	350	0	0
	Lighters, etc.	178	0	0	,, 31	,, Appreciation in value of Wharf	3,058	0	0
,, 31	,, Expenses of Dissolution	200	0	0	,, 31	,, Goodwill, average profit of last 3 years	10,000	0	0
,, 31	,, Balance carried down	26,690	0	0					
		£32,408	0	0			£32,408	0	0
19... Dec. 31	To X, ½ Share	13,345	0	0	19... Dec. 31	By Balance brought down	26,690	0	0
,, 31	,, Y, ⅓ Share	8,896	13	4					
,, 31	,, Z, ⅙ Share	4,448	6	8					
		£26,690	0	0			£26,690	0	0

The amount to be paid out to X on completion of the dissolution would therefore be:—

X. CAPITAL ACCOUNT.

Dr.							Cr.		
		£	s.	d.			£	s.	d.
19... Dec. 31	To Balance carried down	59,217	0	0	19... Dec. 31	By Balance	40,000	0	0
					,, 31	,, Transfer from Realisation Account	13,345	0	0
					,, 31	,, Transfer from Current Account	5,872	0	0
		£59,217	0	0			£59,217	0	0
					19... Dec. 31	By Balance brought down	59,217	0	0

Y and Z, the continuing partners, may prefer to revert to the financial position prior to the retirement of X in so far as Goodwill and the Marine Insurance Fund are concerned. If so, the entries made for the purpose of X's retirement can be reversed as follows:—

JOURNAL.

		Dr.			Cr.		
		£	s.	d.	£	s.	d.
19... Jan. 1	Sundries:— Dr.						
	Y, Capital Account	12,750	0	0			
	Z, Capital Account	6,375	0	0			
	To Goodwill Account				10,000	0	0
	,, Marine Insurance Fund				9,125	0	0*
	Being reversal of entries in Realisation Account dated December 31, 19...						

* This represents Y or Z's proportion of the Fund.

The revaluation of the assets can also be reversed, or again revised, in a similar manner, if desired.

Dissolution by Death. Interest in Lieu of Profits.—Some deeds of partnership provide that upon the death of a partner the representatives of the deceased shall be paid interest at a fixed rate upon the deceased partner's capital from the date of the last Balance Sheet to the day of death. This interest is in lieu of any share in the profits which may have accrued, and is usually fixed at a higher rate than is allowed on capital in the ordinary course. Such an agreement obviates the necessity of preparing special accounts up to the date of death, but it may, of course, operate harshly as between the surviving partner and the representatives of the deceased partner if abnormal profits or losses have occurred since the date of the last Balance Sheet prior to the death.

Illustration.—A, B, and C are partners and share profits in the proportion one-half, one-fourth, and one-fourth respectively. On December 31, 19..., the date of the last Balance Sheet, the Capital Accounts stood as follows: A, £10,000; B, £8,500; C, £8,000. On March 31 following, the credit balances of the Current Accounts were: A, £952; B, £786; C, £810. It was provided by the partnership deed that, in the event of a partner's death, interest at the rate of 8% per annum was to be allowed from the date of the last Balance Sheet to the date of death, in lieu of a share of profits for the same period. Goodwill was to be valued at one year's purchase of the average of the profits for the three years ended on the date of the last Balance Sheet prior to the death. The profits for these years were: £7,896, £3,274, and £6,842, the average therefore being £6,004. A died on March 31, 19... The amount payable to the representatives of A would appear in his Capital Account as follows:—

A. CAPITAL ACCOUNT.

Dr. Cr.

19...		£	s.	d.	19...		£	s.	d.
Mar. 31	To Balance carried down . .	14,154	0	0	Dec. 31	By Balance . .	10,000	0	0
					Mar. 31	,, Transfer from Current Account .	952	0	0
					,, 31	,, Interest on £10,000 at 8% for 3 months * . .	200	0	0
					,, 31	,, Share of Goodwill (half) . .	3,002	0	0
		£14,154	0	0			£14,154	0	0
					19... Mar. 31	By Balance brought down . .	14,154	0	0

* It might be contended that this Interest should be based not on £10,000 but on the agreed amended capital, *i.e.* £13,954.

Loss on Dissolution.—By way of further illustration, a problem resulting in a loss upon dissolution may prove useful. The journal and ledger entries are identical in principle with those already dealt with in the preceding illustrations, and need not be repeated *in extenso.*

Illustration.—B. Uprichard and L. Inchiquin are equal partners. Trading having proved unsuccessful for the past few years, they decide to wind up the business as on December 31, 19... At that date their Balance Sheet was as follows:—

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.			£	s.	d.
Capital:—					Leasehold Warehouse . .		8,241	0	0
B. Uprichard . .	£10,000				Machinery and Plant . . .		4,110	0	0
L. Inchiquin . .	8,000				Stock		5,821	0	0
		18,000	0	0	Sundry Debtors .	£6,420			
Sundry Creditors		4,490	0	0	*Less* Provision for Bad				
Loan from Bank		2,000	0	0	Debts . .	321			
							6,099	0	0
					Cash in hand		219	0	0
		£24,490	0	0			£24,490	0	0

The assets were realised with the following results: Leasehold Warehouse, £7,850; Machinery and Plant, £3,320; Stock, £5,996; Sundry Debtors, £5,997. The goodwill, name, and trade marks of the firm were sold for £200. The expenses of dissolution were £150. When settling with the creditors, it was found that a debt of £50 had been omitted from the above Balance Sheet. Dealing with this problem upon the alternative method already illustrated, the more important accounts would appear as follows:—

16

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19...								
Dec. 31	Realisation Account . . . . . . Dr.		1,604	0	0			
	To Sundry Assets:—							
	Leasehold Warehouse					391	0	0
	Machinery and Plant					790	0	0
	Sundry Debtors					423	0	0
	Being transfer of the losses on sale of these assets.							
,, 31	Stock . . . . Dr.		175	0	0			
	To Realisation Account					175	0	0
	Being transfer of the profit on the sale of this asset.							
,, 31	Provision for Bad Debts . . . . . . Dr.		321	0	0			
	To Realisation Account					321	0	0
	Being transfer of balance of this reserve account.							

CASH BOOK.

1 Dr. | 2 Cr.

			£	s.	d.				£	s.	d.
19...						19...					
Dec. 31	To Balance . .	√	219	0	0	Dec. 31	By Sundry Creditors	√	4,490	0	0
,, 31	,, Cash. Proceeds realisation of Sundry Assets:					,, 31	,, Loan from Bank	√	2,000	0	0
	Leasehold Warehouse .	10	7,850	0	0	,, 31	,, Expenses of Dissolution .	3	150	0	0
	Machinery and Plant . .	√	3,320	0	0	,, 31	,, Liability omitted from Balance Sheet . .	3	50	0	0
	Stock . .	√	5,996	0	0	,, 31	,, Cash. B. Uprichard . .	5	9,446	0	0
	Sundry Debtors.	√	5,997	0	0	,, 31	,, Cash. L. Inchiquin . .	7	7,446	0	0
,, 31	,, Cash. Proceeds Sale of Goodwill, etc. . .	4	200	0	0						
			£23,582	0	0				£23,582	0	0

LEDGER.

Realisation Account.

3 Dr. 4 Cr.

	J.	£	s.	d.		J.	£	s.	d.
To Loss on Realisation of :—					By Profit on Realisation of Stock.	16	175	0	0
Leasehold Warehouse . .	16	391	0	0	,, Provision for Bad Debts . .	—	321	0	0
Machinery and Plant . .	—	790	0	0	,, Proceeds Sale of Goodwill .	C.B. 1	200	0	0
Sundry Debtors	—	423	0	0	,, Balance carried down . .	√	1,108	0	0
,, Expenses of Realisation .	C.B. 1	150	0	0					
,, Liability omitted from Balance Sheet . .	2	50	0	0					
		£1,804	0	0			£1,804	0	0
To Balance brought down . .	√	1,108	0	0	By B. Uprichard .	5	554	0	0
					,, L. Inchiquin .	7	554	0	0
		£1,108	0	0			£1,108	0	0

B. Uprichard. Capital Account.

5 Dr. 6 Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Realisation Account . .	4	554	0	0	19... Dec. 31	By Balance . .	√	10,000	0	0
,, 31	,, Balance carried down . .	√	9,446	0	0						
			£10,000	0	0				£10,000	0	0
19... Dec. 31	To Cash . . .	C.B. 2	9,446	0	0	19... Dec. 31	By Balance brought down . .	√	9,446	0	0

L. Inchiquin. Capital Account.

7 Dr. 8 Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Realisation Account . .	4	554	0	0	19... Dec. 31	By Balance . .	√	8,000	0	0
,, 31	,, Balance carried down . .	√	7,446	0	0						
			£8,000	0	0				£8,000	0	0
19... Dec. 31	To Cash . . .	C.B. 2	7,446	0	0	19... Dec. 31	By Balance brought down . .	√	7,446	0	0

Leasehold Warehouse.

9 Dr. 10 Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance . .	√	8,241	0	0	19... Dec. 31	By Cash . .	C.B. 1	7,850	0	0
						,, 31	,, Realisation Account . .		391	0	0
			£8,241	0	0				£8,241	0	0

The remaining asset accounts duplicate the Leasehold Warehouse Account given below.

EXAMINATION QUESTION.

A, B, and C carried on business in partnership, and on December 31 their Balance Sheet was as follows:—

LIABILITIES.	£	ASSETS.	£
Sundry Creditors	4,500	Land and Buildings	4,000
A, Loan	6,000	Plant and Machinery	8,000
Capital Accounts—		Loose Plant and Tools	1,500
A	12,000	Stock in Trade	10,000
B	10,000	Sundry Debtors	14,000
C	7,500	Cash at Bank and in hand	2,500
	£40,000		£40,000

They decide to dissolve their partnership as at December 31. A retires, and B and C carry on the business, and agree to purchase A's share in the capital of the firm in the proportions in which they share profits and losses. Profits and losses are shared: A, two-fifths; B, two-fifths; C, one-fifth. A agrees to allow his loan to remain in the business.

For the purposes of the dissolution, the Goodwill is valued at £5,000, and the assets are to be taken as follows: Land and Buildings, £4,500; Plant and Machinery as in the Balance Sheet, subject to 10% depreciation; Loose Plant and Tools as in the Balance Sheet; Stock-in-Trade at £9,000; Sundry Debtors as in the Balance Sheet, subject to £1,158 provision for bad debts and an allowance of 5% for discounts and costs of collection (calculate to nearest £).

The liability to Sundry Creditors is taken over by B and C, subject to an allowance of £200 for discounts.

B and C continue to share profits and losses in the same proportions as heretofore.

Draw up the Realisation Account, the Ledger Accounts, and the Balance Sheet of B and C as on January 1 next. (*Chartered Accountants—Final.*)

Solution.

24

JOURNAL.

			DR. £	s.	d.	CR. £	s.	d.
Realisation Account	Dr.	1	3,600	0	0			
To Sundry Assets:—								
Plant and Machinery (10% Depreciation)		14				800	0	0
Sundry Debtors (Provision for Bad Debts)		20				1,158	0	0
Sundry Debtors (Discounts and Costs)						642	0	0
Stock		18				1,000	0	0
Being transfer of the losses on these assets.								
Land and Buildings	Dr.	11	500	0	0			
To Realisation Account		2				500	0	0
Being transfer of the profit on this asset.								
Goodwill Account	Dr.	9	5,000	0	0			
To A		4				2,000	0	0
,, B		6				2,000	0	0
,, C		8				1,000	0	0
Being share of the valuation of Goodwill.								
Sundry Creditors	Dr.	25	200	0	0			
To Realisation Account		2				200	0	0
Being reserve for discounts, etc.								

LEDGER.

REALISATION ACCOUNT.

1 2

DR. CR.

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Loss on Realisation of :—					19... Dec. 31	By Profit on Land and Buildings	24	500	0	0
	Plant and Machinery . .	24	800	0	0	„ 31	„ Reserve for Discounts, etc., on Sundry Creditors . .	24	200	0	0
	Sundry Debtors .	—	1,800	0	0	„ 31	„ Balance carried down . .	√	2,900	0	0
	Stock . .	—	1,000	0	0						
			£3,600	0	0				£3,600	0	0
19... Dec. 31	To Balance brought down . .	√	2,900	0	0	19... Dec. 31	By A, ⅖ loss . .	3	1,160	0	0
						„ 31	„ B, ⅖ loss . .	5	1,160	0	0
						„ 31	„ C, ⅕ loss . .	7	580	0	0
			£2,900	0	0				£2,900	0	0

A. CAPITAL ACCOUNT.

3 4

DR. CR.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Loss on Realisation .	2	1,160	0	0	19... Dec. 31	By Balance . .	√	12,000	0	0
„ 31	„ Balance transferred :—					„ 31	„ Share of Goodwill	J. 24	2,000	0	0
	B, two-thirds .	6	8,560	0	0						
	C, one-third .	8	4,280	0	0						
			£14,000	0	0				£14,000	0	0

B. CAPITAL ACCOUNT.

5 6

DR. CR.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Loss on Realisation . . .	2	1,160	0	0	19... Dec. 31	By Balance . .	√	10,000	0	0
„ 31	„ Balance carried down . .	√	19,400	0	0	„ 31	„ Share of Goodwill	J. 24	2,000	0	0
						„ 31	„ Transfer from A's Capital Account	3	8,560	0	0
			£20,560	0	0				£20,560	0	0
						19... Dec. 31	By Balance brought down . .	√	19,400	0	0

C. CAPITAL ACCOUNT.

7 8

DR. CR.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Loss on Realisation . . .	2	580	0	0	19... Dec. 31	By Balance . .	√	7,500	0	0
„ 31	„ Balance carried down . .	√	12,200	0	0	„ 31	„ Share of Goodwill	J. 24	1,000	0	0
						„ 31	„ Transfer from A's Capital Account	3	4,280	0	0
			£12,780	0	0				£12,780	0	0
						19... Dec. 31	By Balance brought down . .	√	12,200	0	0

LEDGER—*continued.*

GOODWILL ACCOUNT.

9 **Dr.** | **Cr.** 10

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Sundries . .	24	5,000	0	0						

LAND AND BUILDINGS.

11 **Dr.** | **Cr.** 12

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance . .	√	4,000	0	0	19... Dec. 31	By Balance carried down . .	√	4,500	0	0
" 31	" Realisation Account . .	J. 24	500	0	0						
			£4,500	0	0				£4,500	0	0
19... Dec. 31	To Balance brought down . .	√	4,500	0	0						

PLANT AND MACHINERY.

13 **Dr.** | **Cr.** 14

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	√	8,000	0	0	19... Dec. 31	By Realisation Account . .	24	800	0	0
						" 31	" Balance carried down . .	√	7,200	0	0
			£8,000	0	0				£8,000	0	0
19... Dec. 31	To Balance brought down . .	√	7,200	0	0						

LOOSE PLANT AND TOOLS.

15 **Dr.** | **Cr.** 16

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance . .	√	1,500	0	0						

STOCK.

17 **Dr.** | **Cr.** 18

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	√	10,000	0	0	19... Dec. 31	By Realisation Account . .	24	1,000	0	0
						" 31	" Balance carried down . .	√	9,000	0	0
			£10,000	0	0				£10,000	0	0
19... Dec. 31	To Balance brought down . .	√	9,000	0	0						

LEDGER—*continued.*

SUNDRY DEBTORS.

19 Dr. — 20 Cr.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance	√	14,000	0	0	19... Dec. 31	By Realisation Account— Bad Debts Provision	24	1,158	0	0
							Discounts and Costs (5% on £14,000–£1,158)		642	0	0
						„ 31	„ Balance carried down	√	12,200	0	0
			£14,000	0	0				£14,000	0	0
19... Dec. 31	To Balance brought down	√	12,200	0	0						

A. LOAN ACCOUNT.

21 Dr. — 22 Cr.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Balance	√	6,000	0	0

CASH BOOK.

23 Dr. — 24 Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance	√	2,500	0	0						

Note.—It is assumed that B and C paid direct for their share in the business.

SUNDRY CREDITORS.

25 Dr. — 26 Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Reserve for Discounts, etc.	24	200	0	0	19... Dec. 31	By Balance	√	4,500	0	0
„ 31	„ Balance carried down	√	4,300	0	0						
			£4,500	0	0				£4,500	0	0
						19... Dec. 31	By Balance brought down	√	4,300	0	0

B & C.

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.		£	s.	d.
Capital:—					Goodwill	5,000	0	0
B	£19,400				Land and Buildings	4,500	0	0
C	12,200				Plant and Machinery	7,200	0	0
		31,600	0	0	Loose Plant and Tools	1,500	0	0
Loan Account (A)		6,000	0	0	Stock	9,000	0	0
Sundry Creditors		4,300	0	0	Sundry Debtors	12,200	0	0
					Cash in hand and at Bank	2,500	0	0
		£41,900	0	0		£41,900	0	0

The student should realise that, in connection with all dissolutions, an account which has been adopted by partners for one purpose, *e.g.*

the determination of profits during the continuance of the partnership as a going concern, is not necessarily compellable upon them for another purpose, *e.g.* the fixing of the valuation of the assets upon the death or retirement of a partner. Thus, in *Cruikshank* v. *Sutherland*, [1923] 128 L.T. 449, the articles provided that accounts were to be made up to April 30 in each year, and each partner was to be bound thereby, save for manifest errors; they also provided that the amount of the share of a deceased partner was to be made up to April 30 next after his decease. The assets included certain shares and debentures which had increased in value as against the book or cost figure. It was *held* that, in the absence of any uniform usage to the contrary (*i.e.* as to valuations on *death* or *retirement* of a partner), the assets of the firm should be taken at their fair value to the firm at the date of the account, and not at their book values.

Loss on Realisation. One Partner's Capital Account in Debit.—Previous illustrations have been based upon the assumption that the Capital Accounts of all partners were in credit. Should a debit balance be shown, the partner concerned must pay in a sufficient sum to discharge his liability, otherwise it will not be possible to pay the remaining partners the sums standing to their credit when the realisation is completed.

Illustration.—G. Emblem, C. Christine, and A. Ward are in partnership, and share profits one-half to Emblem, and one-quarter each to Christine and Ward. They dissolve partnership and realise the assets. At the date of the dissolution the Balance Sheet of the firm was as follows:—

Emblem, Christine & Ward.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Sundry Assets	7,320	0	0
G. Emblem . .	£6,500				Stock	2,470	0	0
C. Christine . .	3,200				Cash at Bank	1,260	0	0
A. Ward . . .	500							
		10,200	0	0				
Creditors		850	0	0				
		£11,050	0	0		£11,050	0	0

The expenses of the realisation amounted to £374, Sundry Assets realised £4,840, and Stock realised £2,520.

LEDGER.

REALISATION ACCOUNT.

1 Dr.									2 Cr.		
			£	s.	d.				£	s.	d.
19... Dec. 31	To Loss on Sale of Sundry Assets .	✓	2,480	0	0	19... Dec. 31	By Profit on Sale of Stock . .	✓	50	0	0
" 31	" Expenses of Realisation .	C.B. 4	374	0	0	" 31	" Balance carried down . .	✓	2,804	0	0
			£2,854	0	0				£2,854	0	0
19... Dec. 31	To Balance brought down . .	✓	2,804	0	0	19... Dec. 31	By G. Emblem, Share of Loss . .	5	1,402	0	0
						" 31	" C. Christine, Share of Loss .	7	701	0	0
						" 31	" A. Ward, Share of Loss . .	9	701	0	0
			£2,804	0	0				£2,804	0	0

LEDGER—*continued.*

CASH BOOK.

3 Dr. / 4 Cr.

			£	s.	d.				£	s.	d.
19...						19...					
Dec. 31	To Balance . .	√	1,260	0	0	Dec. 31	By Sundry Creditors	√	850	0	0
" 31	" Cash, Proceeds Sale of Sundry Assets . .	√	4,840	0	0	" 31	" Expenses of Realisation . .	1	374	0	0
" 31	" Cash, Proceeds Sale of Stock .	√	2,520	0	0	" 31	" G. Emblem .	5	5,098	0	0
" 31	" A. Ward (Cash paid in) . .	10	201	0	0	" 31	" C. Christine .	7	2,499	0	0
			£8,821	0	0				£8,821	0	0

G. EMBLEM. CAPITAL ACCOUNT.

5 Dr. / 6 Cr.

			£	s.	d.				£	s.	d.
19...						19...					
Dec. 31	To Realisation Account . .	2	1,402	0	0	Dec. 31	By Balance . .	√	6,500	0	0
" 31	" Balance carried down . .	√	5,098	0	0						
			£6,500	0	0				£6,500	0	0
19...		C.B.				19...					
Dec. 31	To Cash . . .	4	5,098	0	0	Dec. 31	By Balance brought down . .	√	5,098	0	0

C. CHRISTINE. CAPITAL ACCOUNT.

7 Dr. / 8 Cr.

			£	s.	d.				£	s.	d.
19...						19...					
Dec. 31	To Realisation Account . .	2	701	0	0	Dec. 31	By Balance . .	√	3,200	0	0
" 31	" Balance carried down . .	√	2,499	0	0						
			£3,200	0	0				£3,200	0	0
19...		C.B.				19...					
Dec. 31	To Cash . . .	4	2,499	0	0	Dec. 31	By Balance brought down . .	√	2,499	0	0

A. WARD. CAPITAL ACCOUNT.

9 Dr. / 10 Cr.

			£	s.	d.				£	s.	d.
19...						19...					
Dec. 31	To Realisation Account . .	2	701	0	0	Dec. 31	By Balance . .	√	500	0	0
						" 31	" Balance carried down . .	√	201	0	0
			£701	0	0				£701	0	0
19...						19...		C.B.			
Dec. 31	To Balance brought down . .	√	201	0	0	Dec. 31	By Cash . .	3	201	0	0

The Sundry Creditors, Sundry Assets, and remaining Ledger accounts have been illustrated in several of the preceding problems, and need not occupy space again. It is possible, of course, that the results of the realisation may prove so unfortunate that the Capital Accounts of all the partners are in debit. This would mean that the available cash was insufficient to meet the claims of the outside creditors. When the amounts standing to the debit of the partners have been paid in, exactly enough cash will be available to meet the outside liabilities.

Loss on Realisation. One or More Partners Insolvent.—Prior to the case of *Garner* v. *Murray*, it had been the practice to include losses accruing from the default of a partner to make good his share of trading losses amongst those "losses, including losses and deficiencies of capital" referred to in S. 44 of the *Partnership Act*, 1890. Guided by that section of the Act, the accountant added the deficiency arising from a partner's default to the trading deficiency of the firm, and divided the total deficiency between the solvent partners in the proportion in which they shared the profits of the firm. It is submitted that from an accountant's point of view this treatment is the logically correct treatment. But the rule laid down by Mr. Justice Joyce in the case of *Garner* v. *Murray*, [1904] 1 Ch. 57 introduced a different principle, a principle that has given rise to acute controversy amongst accountants, and indeed to the expression of divergent views as to the manner in which the principle is to be applied. In the author's opinion, it would be unprofitable to traverse this argumentative field *de novo*, but inasmuch as the learned judge's decision appears to have assumed considerable importance in examination work, it may be advisable to deal with the case itself in some detail.

Garner, Murray, and Wilkins were in partnership in the year 1900 under a parol agreement. The capital of the firm was contributed in unequal proportions, but profits and losses were to be shared equally (one-third). The partnership was dissolved by order of the Court as from June 30, 1900. On completion of the dissolution the financial position was approximately as follows. Wilkins was insolvent and unable to contribute anything.

Garner, Murray & Wilkins.

STATEMENT OF AFFAIRS, JUNE 30, 1900.

		£	s.	d.		£	s.	d.
Capital :—					Wilkins (Debit Balance of Capital Account)	263	0	0
Garner	£2,500				Loss on Realisation	635	0	0
Murray	314	2,814	0	0	Cash	1,916	0	0
		£2,814	0	0		£2,814	0	0

Left to his own judgment, and guided by S. 44 of the Act of 1890, the accountant would have treated Wilkins's deficiency, £263, as a loss on realisation, added it to the firm's deficiency, £635, and then divided the aggregate loss, £898, between the solvent partners, one-half to each, since they shared profits and losses equally. By this treatment, Murray would have paid Garner £135, and Garner would have taken the whole of the cash balance, £1,916.

The Court, however, decided that Wilkins's deficiency must be distinguished from the losses of the firm as a whole, and that "the assets must be applied in paying to each partner rateably what was due from the firm to him in respect of capital, account being taken of the equal contributions to be made by him towards the deficiency of capital." This decision and the method of its application have quite naturally given rise to much controversy. A reasonable interpretation of the decision is that, after fulfilling all the firm's outside obligations, losses sustained by some of the partners owing to the default of another partner must not be treated as partnership losses to be borne in the ratio in which profits and losses are shared, but as a loss to be borne by the individual solvent partners rateably according to the amount of capital standing to their credit in the books of the firm, after taking into account the contributions made by them towards the deficiency of capital.

The effect of the decision in the case of Garner, Murray, and Wilkins was to make the firm's deficiency, £635, divisible equally amongst the three partners, whereas Wilkins's deficiency, £263, was to be borne by the two solvent partners in proportion to the credit balances of their capital accounts.

Procedure following Garner v. *Murray*.—So long as the ruling in *Garner* v. *Murray* stands, the procedure is as follows:—

Prepare a Realisation Account in the ordinary way. Divide the deficiency between the partners in the proportions in which profits or losses were shared. Open a Capital Account for each partner, crediting him with his capital and debiting him with his share of the firm's deficiency as shown by the Realisation Account. Rule off the insolvent partner's Capital Account, and bring down the (debit) balance, which represents the deficiency of the insolvent partner. Such deficiency constitutes for the solvent partners a further loss which must then be apportioned between them in proportion to their respective Capital Accounts. The Capital Account balances to be used as the basis for dividing up the insolvent partner's deficiency among the solvent partners are: (*a*) the original capitals of the solvent partners—if these have remained unaltered at a fixed sum down to the dissolution; or (*b*) if the original capitals have been varied from time to time by agreement or periodical accounting between the partners, then the capitals as they stood after the last such variation before the dissolution.

It is submitted that the balances on Current Accounts are ignored in fixing the ratio in which the loss has to be borne by the remaining partners.

Illustration.—A, B, and C are equal partners. Dissolution takes place. C is bankrupt. A Realisation Account is prepared, and the deficiency is debited in equal shares to the three partners, whose capital accounts, original and final, stood as follows:—

	Original Capital.		Capital Account Balance after debiting share of loss on Dissolution Realisation.	
		£		£
A	Credit Balance . .	4,000	Credit Balance . .	3,000
B	Credit Balance . .	2,000	Credit Balance . .	1,000
C	Credit Balance . .	600	Debit Balance . .	400

The deficiency shown by C's account (£400) must be divided as to £266 13*s*. 4*d*. (two-thirds) to A, and as to £133 6*s*. 8*d*. (one-third) to B. The balance of cash in hand will then exactly suffice to pay out to the two solvent partners, and, when posted, will close the books.

Illustration.—V. Verdier, M. Neil, and W. A. Richardson were in partnership, and shared profits as to one-half to Verdier, one-third to Neil, and one-sixth to Richardson. They decided to dissolve partnership as on December 31, 19... During the realisation of the assets Richardson was adjudicated a bankrupt. His estate proved insufficient to meet the preferential debts, no contribution from him towards his share of the firm's deficiency was therefore possible.

The Balance Sheet of the firm as on December 31, 19..., was as under. The capital accounts of the partners were originally: V. Verdier, £10,000, M. Neil, £8,000, and W. A. Richardson, £1,000; but by subsequent yearly adjustments made by agreement between the partners at the annual accounting periods, the capital account balances had been reduced to those shown in the Balance Sheet subjoined:—

BALANCE SHEET, DECEMBER, 31 19...

Dr.	£	s.	d.	Cr.	£	s.	d.
Capital—				Leasehold Factory	3,000	0	0
V. Verdier	6,000	0	0	Plant and Machinery	2,800	0	0
M. Neil	3,000	0	0	Patents	1,000	0	0
Sundry Creditors	5,214	0	0	Fixtures and Fittings	320	0	0
				Stock	2,680	0	0
				Sundry Debtors	3,214	0	0
				Cash	1,000	0	0
				W. A. Richardson, Capital Account overdrawn	200	0	0
	£14,214	0	0		£14,214	0	0

The assets, other than Cash, realised the following amounts: Leasehold, £2,460; Plant and Machinery, £2,000; Patents, nil; Fixtures, £100; Stock, £2,000; Book Debts, £2,720. A contingent liability, amounting to £200, not provided for in the above balance sheet, materialised during the realisation. The expenses of realisation amounted to £62. Close the books of the firm in accordance with the ruling in *Garner* v. *Murray*.

LEDGER.

REALISATION ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Loss on Realisation of Assets	3,734	0	0	By Deficiency—			
,, Contingent liability matured	200	0	0	V. Verdier (one-half)	1,998	0	0
,, Expenses	62	0	0	M. Neil (one-third)	1,332	0	0
				W. A. Richardson (one-sixth)	666	0	0
	£3,996	0	0		£3,996	0	0

CASH BOOK.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Balance	1,000	0	0	By Sundry Creditors	5,214	0	0
,, Sundry Assets—Amount realised	9,280	0	0	,, Realisation Account: Expenses . £62 Contingent liability . 200	262	0	0
				,, Balance carried down	4,804	0	0
	£10,280	0	0		£10,280	0	0
To Balance brought down	4,804	0	0	By V. Verdier	3,424	13	4
				,, M. Neil	1,379	6	8
	£4,804	0	0		£4,804	0	0

LEDGER—*continued.*

V. VERDIER, CAPITAL ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Realisation Account (share of loss) .	1,998	0	0	By Balance . .	6,000	0	0
„ Balance carried down	4,002	0	0				
	£6,000	0	0		£6,000	0	0
To Share of Loss on W. A. Richardson's Account ($\frac{6000}{9000}$ths) .	577	6	8	By Balance brought down . .	4,002	0	0
„ Cash . . .	3,424	13	4				
	£4,002	0	0		£4,002	0	0

M. NEIL, CAPITAL ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Realisation Account (share of loss) .	1,332	0	0	By Balance . .	3,000	0	0
„ Balance carried down	1,668	0	0				
	£3,000	0	0		£3,000	0	0
To Share of Loss on W. A. Richardson's Account ($\frac{3000}{9000}$ths) .	288	13	4	By Balance brought down . .	1,668	0	0
„ Cash . . .	1,379	6	8				
	£1,668	0	0		£1,668	0	0

W. A. RICHARDSON, CAPITAL ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Balance . . .	200	0	0	By Balance carried down . .	866	0	0
„ Realisation Account (share of loss) .	666	0	0				
	£866	0	0		£866	0	0
To Balance brought down	866	0	0	By V. Verdier ($\frac{6000}{9000}$ths) .	577	6	8
				„ M. Neil ($\frac{3000}{9000}$ths) .	288	13	4
	£866	0	0		£866	0	0

Periodical Payments during a Prolonged Dissolution.—Occasionally the winding-up of a partnership takes some considerable time, in order that the several assets may be realised to the utmost advantage, although the partners naturally desire cash distributions on account of their shares from time to time, as and when funds become available. In such cases, if there is any doubt as to the continued solvency of any partner, it is advisable to adopt a cautious policy and to regulate the payments to each partner so that there is little or no risk of his having to refund any money received by him when the final position is determined. Consequently, periodical distributions should not be proportionate either to the partner's capitals *or* to their shares of profit or loss, but should be made on the assumption that no further realisations will take place beyond the sums already received.

Illustration.—F, G, and H have capitals of £800, £500, and £700, and share profits and losses as to one-half, one-third, and one-sixth respectively. After paying the creditors, the following sums become available, it being agreed that they shall be distributed as and when determined:—

			£
Jan.	1.	Net Proceeds of Sale of Machinery	100
Mar.	1.	Cash Realised on account of Book Debts . .	400

Further assets remain to be realised. You are required to show the sums to be paid to the partners out of the amounts stated.

Solution.			F.	G.	H.
			£	£	£
Jan.	1.	Balances of Capitals, Cr. . . .	800	500	700
		Payment made			100
		Balances being then . . .	800	500	600
Mar.	1.	Payments made	50		350
		Balances being now as 3 : 2 : 1 .	750	500	250

Note.—If no further sums are available, the balances on the capital accounts are now proportionate to the partners' *risk of loss*, on a basis of £1,500, *i.e.* total capitals of £2,000, less net realisations £500. When additional amounts become available, say £300 on June 1, they can safely be distributed as to F one-half, £150; G one-third, £100; and H one-sixth, £50, *i.e.* in the common ratio of capitals *and* risk of loss. Should a partner be insolvent and so unable to contribute his share of the loss that would arise should no further realisations be made, then, in adopting the most cautious method of repayment, allowance might be made for the possibility of having to deal with the partner's resulting debit balance under the rule in *Garner* v. *Murray*.

Where all partners are substantial men, there is not the same need for caution, and, indeed, the partners would probably refuse to consider such a method of division. A reasonable method would then be to divide each sum available in the capital ratio, but adjusting for profits or losses to date in the profit-sharing ratio.

***Elliott* v. *Elliott*, [1911] 45 *Accountant Law Reports*, 47.**—This case should be noticed briefly, as it contains several points of interest to accountants. From the decision in this case, it would appear that the amount due to a deceased partner is not a liability of the firm but of *each individual partner*.

Stephen Elliott and his sons Alfred, Charles, and George, were in partnership, sharing profits in the proportion four-elevenths, three-elevenths, two-elevenths, and two-elevenths respectively. The partnership articles provided that upon a death occurring, the surviving partners should assume the liabilities of the firm and take over the deceased partner's share in the assets and goodwill in proportion to their respective shares in the business, and that for this purpose the goodwill was to be valued at £10,000. The surviving partners were to execute a joint and several bond securing the payment of the amount due to the deceased partner in eight half-yearly instalments. Alfred died in 1906, and the amount of his share, valued on the above basis, was treated in the books and Balance Sheet as a liability of the firm to his executors, and payments on account were made from time to time in reduction of the debt. Subsequently, the surviving partners, under a new agreement, fixed the value of the goodwill at £800, the former figure being held to be fictitious.

Elliott, senior, died in September 1910, and his representatives contended that his share should be valued on the basis that the value of the goodwill was £10,000. It was decided that the subsequent agreement, which fixed the value at £800, held good. When an account was taken at the death of Alfred, the stock was valued at selling prices less 30% to arrive at the net value, and that practice was followed until the death of Elliott, senior, when an independent valuer was called in, who valued the stock at a much lower figure than a valuation at selling price less 30% would have shown. The executors of Elliott, senior, contended that the firm was bound by the valuation method adopted in 1906, and sought to set aside the independent valuation. They also questioned whether the debt due to Alfred's executors, half of which remained unpaid, was properly treated as a partnership debt in the Balance Sheet of the firm submitted to them. It was held that the previous stocktakings were for an entirely different purpose than determining the value of a deceased partner's interest in the business, and that the independent valuation was right and proper. It was also held that the audited Balance Sheets were binding upon all the partners, including Elliott, senior, notwithstanding that he was illiterate and unable to understand them.

The amount due to Alfred's executors had been treated in the partnership books as a liability of the firm, and payments on account had been made out of the firm's funds, which had reduced the debt to one-half of its original amount. Seeing that Alfred's executors had accepted the firm's cheques in reduction of the debt, it may naturally be assumed that they considered the firm liable. It was decided, however, that while these payments must stand, the balance still due was a personal liability of the partners individually, not a partnership liability, and that it must not appear in the firm's Balance Sheet. The learned judge said, "I think it is a debt due by each partner to the son's executors as the purchase money for *a personal benefit acquired by that partner*. The balance remaining due must be struck out of the Balance Sheet."

Elliott, senior, had from time to time overdrawn his share of the profits, and had made no refunds to the firm, although the articles provided that overdrawings should be repaid. The amounts had therefore been debited to his capital account. It was contended that this practice had relieved Elliott of his liability to refund, but it was decided that the procedure did not relieve Elliott from liability to refund overdrawings, the amount of which must therefore be treated as an asset of the firm.

The most important of the decisions mentioned above is the one ruling that the surviving partners of a firm are personally liable to the representatives of a deceased partner for his share in the business when ascertained. In the Elliott case, when Alfred's share had been determined on the agreed basis, the amount should have been transferred to the credit of the surviving partners in the ratio in which they shared profits, and those partners would then have become each personally liable to Alfred's estate for a private debt. The payments on account made by the firm's cheques should have been debited as *drawings* in the proper proportions to the Current Accounts of the partners.

This decision may be good law, nevertheless in certain circumstances it may operate harshly. For example, Jones, Brown, and Robinson are partners contributing capital and sharing profits equally. Jones dies, and the amount due to his estate is agreed at £12,000. Under *Elliott* v. *Elliott*, £6,000 is credited to Brown's capital account and £6,000 to Robinson's, and each becomes liable to Jones's representatives for a private debt of £6,000. Future trading results in heavy losses. Apart from the business, Brown and Robinson have no means. Bankruptcy supervenes, and the firm's creditors receive 10s. in the £. Had the debt to Jones been treated as a partnership liability, his representatives would have shared equally with the other creditors in the dividend declared. As it is, Brown and Robinson having no funds, they get nothing.

It is suggested that partnership deeds should clearly stipulate that amounts due to the representatives of a deceased partner are to be treated as a *partnership liability*, if it is desired to avoid the decision in the above case.

Illustration.—H. Dickson, A. Chatenay, and J. Clarke are partners, and share profits one-half, one-fourth, and one-fourth respectively. Dickson retired on January 1, 19..., and Chatenay and Clarke, in accordance with the articles, took over Dickson's share in the proportion in which they shared profits. The goodwill of the business, on the retirement of a partner, was fixed by the articles as of the value of £6,000. The credit balances of the partner's capital accounts as on January 1, 19..., were as follows: Dickson, £15,000; Chatenay, £10,000; Clarke, £8,000. Following the ruling in *Elliott* v. *Elliott*, the undermentioned entries are necessary:—

15

JOURNAL.

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
Goodwill Account	Dr.	7	6,000	0	0			
To H. Dickson, Capital Account		2				3,000	0	0
,, A. Chatenay, Capital Account		4				1,500	0	0
,, J. Clarke, Capital Account		6				1,500	0	0
Being division of goodwill as fixed by the articles of partnership.								
H. Dickson, Capital Account	Dr.	1	18,000	0	0			
To A. Chatenay, Capital Account		4				9,000	0	0
,, J. Clarke, Capital Account		6				9,000	0	0
Being transfer of Dickson's share in the business upon his retirement.								

LEDGER.

1 H. DICKSON. CAPITAL ACCOUNT. 2

Dr.										Cr.		
			J.	£	s.	d.			J.	£	s.	d.
19...							19...					
Jan.	1	To Chatenay, Capital Account .	15	9,000	0	0	Jan. 1	By Balance . .	\	15,000	0	0
,,	1	,, Clarke, Capital Account . .	\	9,000	0	0	,, 1	,, Share of Goodwill . .	15	3,000	0	0
				£18,000	0	0				£18,000	0	0

LEDGER—*continued.*

3 A. CHATENAY. CAPITAL ACCOUNT. 4

Dr. Cr.

			£	s.	d.	19...			£	s.	d.
						Jan. 1	By Balance . .	√	10,000	0	0
						,, 1	,, Share of Goodwill . .	J. 15	1,500	0	0
						,, 1	,, H. Dickson, Capital Account . .	√	9,000	0	0
									£20,500	0	0

5 J. CLARKE. CAPITAL ACCOUNT. 6

Dr. Cr.

			£	s.	d.	19...			£	s.	d.
						Jan. 1	By Balance . .	√	8,000	0	0
						,, 1	,, Share of Goodwill . .	J. 15	1,500	0	0
						,, 1	,, H. Dickson, Capital Account . .	√	9,000	0	0
									£18,500	0	0

7 GOODWILL ACCOUNT. 8

Dr. Cr.

19...		J.	£	s.	d.				£	s.	d.
Jan. 1	To Sundries . .	15	6,000	0	0						

Chatenay and Clarke now become personally liable to Dickson for the amounts transferred to their respective Capital Accounts. If the remaining partners preferred not to create a goodwill account for so large an amount as £6,000, they could have confined the account to the £3,000 to which Dickson was entitled, in which case a Goodwill Account for £3,000 would have been opened, a like amount being credited to Dickson's Capital Account.

Limited Partnerships.—Under *Bovill's Act*, 1865, and subsequently under SS. 2 and 3 of the *Partnership Act*, 1890, it became possible to advance loans to a partnership business in return for a share of profits from the business without incurring the liabilities incident to partnership proper. Such loans could be made, however, only to individuals and not to firms. The principle of limited liability in partnership was first introduced into partnership law by the *Limited Partnership Act*, 1907. By this Act, loans can be made to a firm in return for a share of profits, and Rules applicable to limited partnership, known as *Limited Partnership Rules*, have been issued under the authority of S. 17 of the Act. The advantages afforded by the registration of private limited companies so greatly outweigh those of limited partnerships that very little advantage has been taken of the Act of 1907, which still remains in force at the present day. But the student should, nevertheless, acquaint himself with the provisions of the Act.

Registration.—A statement, signed by all parties, must be filed with the Registrar of Companies, giving: (*a*) the firm name; (*b*) general nature of the business; (c) the full name of each partner; (d) the term of the partnership and the date when it began; (e) a statement that the partnership is limited; (f) the sum contributed by each limited partner, and how paid, whether in cash or otherwise. Notification of any change in the above particulars must also be filed within seven days. The registration fees are: On registration, £2; stamp duty, 10s. per £100 (*Finance Act*, 1933, S. 41 (2)), or fraction thereof on the amount of capital contributed by the limited partner (or partners). The duty of registering under the Act lies with the general partners, but the limited partner (or partners) will be wise in his (or their) interests to make sure that registration has been duly made.

"General" and "Limited" Partners.—A limited partnership may consist of one or more general partners whose liability is unlimited, and one or more limited partners whose liability is limited to the capital they have agreed to contribute to the business. There must be at least one partner of either class; and not more than twenty persons, or ten in the case of a bank, may enter into a limited partnership. A body corporate, *e.g.* a limited company, may become a limited partner.

Examination experience suggests that it is necessary to point out to some students that, although a shareholder under the *Companies Acts*, and a limited partner under the *Limited Partnership Act*, 1907, can strictly limit their personal liability to the amount they agree to subscribe, the *trading liabilities* of the company, or the partnership, cannot be limited. All the resources, in both cases, are liable to meet trade debts and obligations.

Rights of Limited Partners.—A limited partner cannot take part in the management of the business, but, personally or by his agent, he may inspect the books, inquire into the prospects of the business, and offer advice thereon (S. 6 (1)). If he withdraws any of the capital he has contributed to the business, he becomes liable for the debts and obligations of the firm to the extent of the sums withdrawn, as well as to the extent of the balance of his undrawn capital. He may assign his share in the business with the consent of his co-partners (S. 6 (5)), and the assignee is subrogated to the rights and obligations of the assignor, becoming a limited partner in the place of the assignor. If a limited partner "interferes" in the management of the business he may become liable as a general partner for the debts and obligations of the firm. If a general partner becomes a limited partner, or a limited partner assigns his share in the business, notification must be advertised in the *Gazette*.

A limited partner who has given a bank guarantee will not be deemed to have made a payment to the firm in cash, for the guarantee is merely the assumption of a future contingent liability, and he may be held liable as a general partner (*Rayner & Co.* v. *Rhodes*, [1926] 24 *Lloyd's List Reports*, 25).

Dissolution.—A limited partnership is not dissolved by the death, lunacy, or bankruptcy of a limited partner, as an ordinary partnership is, neither can a limited partnership be dissolved by notice given by the limited partner. Upon a dissolution, the affairs of the firm are wound up by the general partners in accordance with the law and rules of Bankruptcy, or of the *Deeds of Arrangement Act*, as the case may demand.

Accounts.—Generally speaking, the accounts of a limited partner do not differ from those of an ordinary partner engaged in similar business, although the provisions of the Act of 1907 may affect the position of the partners as between themselves. The Capital Account of a limited partner will be credited with the amount he contributes, and the heading of the account should make it clear that he is a limited partner. The balance of the limited partner's Capital Account should make it clear that the capital is *fixed*, subject, of course, to any increase in the capital by further contributions. A Current Account, kept upon the lines already explained, should record all the other dealings of a limited partner with the firm.

The outstanding difference in limited partnership book-keeping lies in the treatment of losses. Should losses occur, the limited partner's share will be debited to his Current Account. The partner concerned would not be entitled to withdraw any further sums from the firm until such losses have been recompensed out of subsequent profits. This would seem to be clear from S. 7 of the Act of 1907, which provides that the *Partnership Act* of 1890 applies also to limited partnerships, except as expressly modified, or excluded by the Act of 1907. A limited partner can, of course, claim repayment of advances made by him irrespective of his Current Account, but he cannot withdraw profits until the debit balance of his Current Account has been made good.

But the limited partner is liable only to the extent of the capital he contributes. Therefore, should dissolution occur, the losses charged to his Current Account could not be recovered. If moneys are periodically withdrawn in anticipation of profits which do not materialise, such withdrawals amount to a technical breach of S. 4 (3) of the Act of 1907. In effect they are withdrawals of capital, and should therefore be made good as soon as possible.

Illustration.—Dickson, Chatenay, and Uprichard are in partnership. Dickson and Chatenay are general partners. Uprichard is a limited partner who has contributed £5,000 as capital and is entitled to one-fifth of the profits. Dickson and Chatenay each contributed £4,000 to the capital of the firm, and are entitled to share equally in the balance of the profits.

Dickson, Chatenay & Uprichard.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED JUNE 30, 19...

(FINAL SECTION.)

19...		£	s.	d.	19...		£	s.	d.
June 30	To Dickson, $\frac{2}{5}$ profits .	1,774	0	0	June 30	By Balance brought down, being net profit for the year .	4,435	0	0
,, 30	,, Chatenay, $\frac{2}{5}$ profits .	1,774	0	0					
,, 30	,, Uprichard, $\frac{1}{5}$ profits .	887	0	0					
		£4,435	0	0			£4,435	0	0

BALANCE SHEET, JUNE 30, 19...

		£	s.	d.		£	s.	d.
Capital:—					Sundry Assets	16,705	0	0
Dickson . . .	£4,000				Cash at Bank	1,315	0	0
Chatenay . .	4,000							
Uprichard . .	5,000							
		13,000	0	0				
Current Accounts:—								
Dickson . . .	£985							
Chatenay . .	765							
Uprichard . .	270							
		2,020	0	0				
Sundry Creditors		3,000	0	0				
		£18,020	0	0		£18,020	0	0

After three years of bad trade the annual accounts were as follows:—

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED JUNE 30, 19...

(FINAL SECTION.)

		£	s.	d.			£	s.	d.
19...					19...				
June 30	To Balance brought down, being net loss for the year . .	6,935	0	0	June 30	By Dickson, $\frac{2}{5}$ loss .	2,774	0	0
					,, 30	,, Chatenay, $\frac{2}{5}$ loss .	2,774	0	0
					,, 30	,, Uprichard, $\frac{1}{5}$ loss .	1,387	0	0
		£6,935	0	0			£6,935	0	0

BALANCE SHEET, JUNE 30, 19...

		£	s.	d.			£	s.	d.
Capital:—					Sundry Assets		17,801	0	0
Dickson . . .	£4,000				Cash at Bank		236	0	0
Chatenay . .	4,000				Current Accounts:—				
Uprichard . .	5,000				Dickson . . .	£2,603			
		13,000	0	0	Chatenay . .	3,108			
Sundry Creditors		13,598	0	0	Uprichard . .	2,850			
							8,561	0	0
		£26,598	0	0			£26,598	0	0

Unless the firm recovers prosperity, the position is as follows: Dickson and Chatenay, whose liability is unlimited, will be responsible to the full extent of their resources for the whole of the outside liabilities of the firm. Uprichard cannot be called upon for further contributions, except to make good any sums withdrawn by him and included in the Current Account debit balance of £2,850. He may lose the whole of his £5,000 capital, but that is the end of his liability. Neither can he be called upon to make good the adverse balance of his current account.

Should prosperity return to the firm, it is possible that future profits may accrue to Uprichard that will suffice to extinguish the debit balance of his Current Account and restore his capital to its original amount. In the event of future profits being made, Uprichard cannot withdraw them until he has made good the adverse balance of his Current Account, and so restored his capital to the agreed amount.

Loans.—As in the case of ordinary partners, a limited partner may advance money on loan on agreed terms, quite apart from the capital he has introduced. Such loans are repayable notwithstanding that the partner's Current Account may be overdrawn. There is no right of set-off as between Loan Accounts and Capital and Current Accounts, because a limited partner is under no obligation beyond the amount of his agreed contribution of capital.

Sleeping or Dormant Partners.—Examination candidates frequently confuse a sleeping or dormant partner with a limited partner. The two are quite distinct. A sleeping partner is a partner who takes no active share in the business. He contributes capital in return for a share of the profits, and is as fully liable for the debts and obligations of the firm as is an active partner, for the law recognises no distinction between the two. A limited partner's liability is, as we have seen, restricted to his agreed capital contribution.

Winding Up.—Limited partnerships are now wound up, under the *Bankruptcy Act*, 1914, in the same manner as are ordinary partnerships.

EXAMINATION QUESTION.

C. Fitzgerald and A. Colomb are in partnership, sharing profits as to two-thirds and one-third respectively. On January 1 they took their manager, M. Farmer, into partnership. Farmer was to be credited with £500 at the close of each year, as a partnership salary, and with 5% on the net profits prior to division.

On December 31 the following Trial Balance was extracted from the books of the firm:—

	£	£
C. Fitzgerald, Capital Account		10,000
C. Fitzgerald, Current Account	1,484	
A. Colomb, Capital Account		8,000
A. Colomb, Current Account	863	
M. Farmer, Current Account	321	
Factory and Warehouse	7,868	
Machinery and Plant	9,640	
6% Loan Account (J. Smith)		5,000
Manufacturing Wages	18,767	
Loose Tools	1,576	
Office Salaries and Expenses	3,872	
War Loan Interest		38
Bad Debts	182	
Rates, Taxes, and Insurance (Factory, £922; Office, £240)	1,162	
Travellers' Salaries and Commission	2,326	
5% War Loan	967	
Purchases and Sales	21,642	57,150
Returns (Inwards and Outwards)	324	424
Discount Account (Balance)		189
Audit Fee	55	
Carriage (Inwards, £398; Outwards, £642)	1,030	
Bad Debts, Provision for (January 1)		400
Cash in hand	78	
Cash at Bank	236	
Stock (January 1)	5,249	
Sundry Debtors and Creditors	9,760	9,235
Manufacturing Expenses	2,684	
Factory Power and Light	978	
Apprentices' Premiums		300
Bills Payable		1,265
Machinery Repairs	617	
Factory Space and Power Sublet		350
Interest Account	150	
Office Furniture	520	
	£92,351	£92,351

You are required to prepare Manufacturing and Profit and Loss Accounts for the year ended December 31, and a Balance Sheet as on that date.

When preparing these accounts, the following particulars must be taken into consideration: (*a*) Provide for depreciation as follows—Machinery and Plant, 15%; Office Furniture, 7½%. (*b*) The following expenses were owing as on December 31—Wages, £123; Office Salaries, £68; Machinery Repairs, £163. (*c*) Interest at 5% is allowed on Capital. Interest on drawings is to be charged as follows—Fitzgerald, £41; Colomb, £28; Farmer, £8. (*d*) Provide for the six months' interest at 6% due to J. Smith on his Loan as on December 31. (*e*) Carry forward £32, Factory Insurance, to next year. (*f*) On December 31 Stock was valued at £8,787, and Loose Tools at £1,200. (*g*) Provide 5% on the Sundry Debtors for Bad and Doubtful Debts.

[*Note*.—For solution, *see* pp. 225–227.]

EXAMINATION QUESTION.

J. B. Clark, a cigarette manufacturer, agreed to take his manager, L. Hillingdon, into partnership on January 1.

The following terms were agreed: (*a*) A goodwill account amounting to £10,000 was to be created, and a similar amount credited to J. B. Clark. (*b*) L. Hillingdon was to be entitled to a salary of £400 per annum, to be paid monthly. (*c*) Twelve monthly drawings on account of profits were to be made by the partners, *i.e.* J. B. Clark, £60 per month; L. Hillingdon, £20 per month. (*d*) Profits and losses were to be shared as follows: J. B. Clark, two-thirds; L. Hillingdon, one-third. (*e*) L. Hillingdon was to pay in £2,000 as his capital in the business on January 1.

You are to assume that, as on December 31 following, all the entries and payments arising out of the terms of the above agreement had been carried out. In addition to the accounts necessary for the record of the above transactions, the following balances were extracted from the books of the firm as on December 31:—

J. B. Clark, Capital Account (January 1), £20,000; Plant and Machinery, £17,800; Fixtures and Fittings, £2,400; Rent and Rates of Factory, £950; Lighting (Factory £120, Office £24); £144; Licence and Insurance (Factory £300, Office £72), £372; Rent and Rates of Office, £270; Factory Expenses, £571; Factory Power, £494; Office Expenses, £124; Sales: Cigarettes, £151,862; Shorts and Sundries, £2,234; Sales Returns: Cigarettes, £321; Shorts and Sundries, £124; Purchases: Tobacco, £76,294; Sundries, £2,421; Purchases Returns: Tobacco, £1,821; Sundries, £106; Office Salaries, £1,694; Factory Wages, £8,751; Packing Expenses (Charge to Trading Account), £1,792; Carriage (Inwards, £821, Outwards £940), £1,761; Travellers' Salaries and Expenses, £2,371; Advertising, £5,000; Stock (January 1), £16,841; Sundry Creditors, £4,682; Sundry Debtors, £22,540; Leasehold Factory, £10,000; Cash at Bank, £7,240; Cash in hand, £1,070.

You are required to prepare Trading and Profit and Loss Accounts for the year ended December 31, and a Balance Sheet as on that date.

Before preparing the accounts, the following adjustments are necessary: (1) The following depreciation is to be written off—Machinery and Plant, 10%; Fixtures and Fittings, 15%. (2) A provision for Bad Debts is to be made equal to 5% on the Sundry Debtors. (3) A sum equal to 5% of the net profits is to be reserved for distribution as a bonus to the firm's employees. (4) The Stock on hand, as on December 31, was valued at £17,560. (5) 50% of the cost of advertising is to be carried forward. (6) Interest at 5% is to be credited to the partners' Capital Accounts, but no interest is to be charged upon drawings. (7) The following amounts were owing at the end of the year: Factory Wages, £68; Office Salaries, £35.

[*Note*.—For solution, *see* pp. 228–230.]

Solution.

Fitzgerald, Colomb & Farmer.

MANUFACTURING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.		£	s.	d.	Cr.		£	s.	d.
To Stock (January 1)		5,249	0	0	By Sales	£57,150 0 0			
,, Purchases	£21,642 0 0				*Less* Returns	324 0 0			
Less Returns	424 0 0								
		21,218	0	0			56,826	0	0
,, Manufacturing Wages		18,890	0	0	,, Apprentices' Fees *		300	0	0
,, Carriage Inwards		398	0	0	,, Space and Power Sublet		350	0	0
,, Manufacturing Expenses		2,684	0	0	,, Stock (December 31)		8,787	0	0
,, Power and Light		978	0	0					
,, Machinery Repairs		780	0	0					
,, Rates, Taxes, and Insurance		890	0	0					
,, Balance, being Gross Profit, carried to Profit and Loss Account		15,170	0	0					
		£66,203	0	0			£66,203	0	0

* Where apprentices' fees appear in an examination question, candidates should carefully seek for any indication that they cover a period in advance of that covered by the accounts under preparation. If they include any amounts paid for future years, the sums so paid in advance must be carried forward as a liability and deducted from the amount credited in the Manufacturing Account.

Fitzgerald, Colomb & Farmer.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.				£	s.	d.	Cr.	£	s.	d.
To Office Salaries and Expenses				3,940	0	0	By Balance brought from Manufacturing Account	15,176	0	0
,, Travellers' Salaries and Commission				2,326	0	0	,, War Loan Interest	38	0	0
,, Carriage Outwards				632	0	0	,, Discount Account	189	0	0
,, Rates, Taxes, and Insurance				240	0	0				
,, Audit Fee				55	0	0				
,, Bad Debts, Provision (December 31)	£488	0	0							
,, Bad Debts written off	182	0	0							
	670	0	0							
Less Provision (January 1)	400	0	0	270	0	0				
,, Interest on Loan				300	0	0				
,, Depreciation *:—										
Machinery and Plant (15%)	£1,446	0	0							
Office Furniture (7½%)	39	0	0							
Loose Tools	376	0	0	1,861	0	0				
,, Balance carried down				5,779	0	0				
				£15,403	0	0		£15,403	0	0
To Salary (Farmer)				500	0	0	By Balance brought down	5,779	0	0
,, Interest on Capital:							,, Interest on Drawings	77	0	0
Fitzgerald	£500	0	0							
Colomb	400	0	0	900	0	0				
,, M. Farmer (5%)	£222	16	0							
,, C. Fitzgerald (two-thirds balance)	2,822	2	8							
,, A. Colomb (one-third balance)	1,411	1	4	4,456	0	0				
				£5,856	0	0		£5,856	0	0

* Practice varies as to the treatment of Depreciation on Machinery and Loose Tools. In some cases these charges are, perhaps more logically, debited to the Manufacturing Account.

Fitzgerald, Colomb & Farmer.

BALANCE SHEET, DECEMBER 31, 19..

	£	s.	d.	£	s.	d.	£	s.	d.
Capital :—									
C. Fitzgerald				10,000	0	0			
A. Colomb				8,000	0	0			
							18,000	0	0
Current Accounts :—									
C. Fitzgerald :									
Balance				1,484	0	0			
Interest on Drawings				41	0	0			
				1,525	0	0			
Share of Profits	£2,822	2	8						
Interest on Capital	500	0	0						
				3,322	2	8			
							1,797	2	8
A. Colomb :									
Balance				863	0	0			
Interest on Drawings				28	0	0			
				891	0	0			
Share of profits	£1,411	1	4						
Interest on Capital	400	0	0						
				1,811	1	4			
							920	1	4
M. Farmer :									
Balance				321	0	0			
Interest on Drawings				8	0	0			
				329	0	0			
Share of Profits	£222	16	0						
Salary	500	0	0						
				722	16	0			
							393	16	0
Loan (J. Smith)				5,000	0	0			
Interest accrued				150	0	0			
							5,150	0	0
Sundry Creditors				9,235	0	0			
Do. (Wages £123, Salaries £68, Repairs £163)				354	0	0			
Bills Payable				1,265	0	0			
							10,854	0	0
							£37,115	0	0

	£	s.	d.	£	s.	d.
Factory and Warehouse				7,868	0	0
Machinery and Plant	9,640	0	0			
Less Depreciation	1,446	0	0			
				8,194	0	0
Office Furniture	520	0	0			
Less Depreciation	39	0	0			
				481	0	0
Loose Tools	1,576	0	0			
Less Depreciation	376	0	0			
				1,200	0	0
Stock				8,787	0	0
Sundry Debtors	9,760	0	0			
Less Provision	488	0	0			
				9,272	0	0
5% War Loan				967	0	0
Cash at Bank	236	0	0			
Cash in hand	78	0	0			
				314	0	0
Amounts paid in advance carried forward				32	0	0
				£37,115	0	0

Solution.

Clark & Hillingdon.

TRADING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.		£	s.	d.	£	s.	d.	Cr.		£	s.	d.	£	s.	d.
To Stock (January 1) . .					16,841	0	0	By Sales—							
,, Purchases—								Cigarettes .	£151,862						
Tobacco .	£76,294							*Less* Returns	321	151,541	0	0			
Less Returns	1,821	74,473	0	0				Shorts and Sundries .	£2,234						
Sundries .	£2,421							*Less* Returns	124	2,110	0	0	153,651	0	0
Less Returns	106	2,315	0	0	76,788	0	0	,, Stock (December 31) .					17,560	0	0
,, Factory Wages . .					8,819	0	0								
,, Packing Expenses . .					1,792	0	0								
,, Carriage Inwards . .					821	0	0								
,, Rent and Rates . .					950	0	0								
,, Lighting					120	0	0								
,, Factory Power. . .					494	0	0								
,, Factory Expenses . .					571	0	0								
,, Licence and Insurances .					300	0	0								
,, Balance, being Gross Profit for the year, carried to Profit and Loss Account					63,715	0	0								
					£171,211	0	0						£171,211	0	0

Clark & Hillingdon.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

DR.		£	s.	d.	CR.	£	s.	d.
To Salaries		1,729	0	0	By Balance brought from Trading Account	63,715	0	0
,, Travellers' Salaries and Expenses		2,371	0	0				
,, Office Lighting		24	0	0				
,, Rent and Rates		270	0	0				
,, Insurance		72	0	0				
,, Office Expenses		124	0	0				
,, Carriage Outwards		940	0	0				
,, Advertising		2,500	0	0				
,, Depreciation—								
Plant (10%)	£1,780 0 0							
Fixtures (15%)	360 0 0	2,140	0	0				
,, Provision for Bad Debts		1,127	0	0				
,, Bonus to Staff (5% on £52,418)		2,620	18	0				
,, Balance carried down, being Net Profit for the year		49,797	2	0				
		£63,715	0	0		£63,715	0	0
To Interest on Capital (5%)—					By Balance brought down	49,797	2	0
J. B. Clark	£1,500 0 0							
L. Hillingdon	100 0 0	1,600	0	0				
,, Salary (L. Hillingdon)		400	0	0				
,, J. B. Clark (two-thirds)	£31,864 14 8							
,, L. Hillingdon (one-third)	15,932 7 4	47,797	2	0				
		£49,797	2	0		£49,797	2	0

Note.—Partners' Salaries and Interest are appropriations of profit and, unless otherwise agreed, should not be charged before calculating the bonus to employees.

Clark & Hillingdon.

BALANCE SHEET, DECEMBER 31, 19...

				£	s.	d.
Capital :—						
J. B. Clark—						
As at December 31, 19...	£20,000	0	0			
Add Goodwill	10,000	0	0	30,000	0	0
L. Hillingdon—						
As at December 31, 19...				2,000	0	0
Current Accounts :—						
J. B. Clark—						
Interest on Capital	£1,500	0	0			
Share of Profits	31,864	14	8			
	33,364	14	8			
Less Drawings	720	0	0	32,044	14	8
L. Hillingdon—						
Interest on Capital	£100	0	0			
Share of Profits	15,932	7	4			
	16,032	7	4			
Less Drawings	240	0	0	15,792	7	4
Sundry Creditors	£4,682	0	0			
Ditto. Wages owing	68	0	0			
Ditto. Salaries owing	35	0	0			
Ditto. Bonus to Staff	2,620	18	0	7,405	18	0
				£87,843	0	0

				£	s.	d.
Goodwill				10,000	0	0
Leasehold Factory				10,000	0	0
Plant and Machinery	£17,800	0	0			
Less Depreciation (10%)	1,780	0	0	16,020	0	0
Fixtures and Fittings	£2,400	0	0			
Less Depreciation (15%)	360	0	0	2,040	0	0
Stock				17,560	0	0
Sundry Debtors	£22,540	0	0			
Less Provision for Bad Debts at 5%	1,127	0	0	21,413	0	0
Advertising carried forward				2,500	0	0
Cash at Bank	£7,240	0	0			
Cash in hand	1,070	0	0	8,310	0	0
				£87,843	0	0

EXAMINATION QUESTIONS.

1. What is a partnership?

State the advantages to be derived by keeping separate Capital and Current Accounts for the partners in a firm.

2. Heriott Brothers consists of three partners (A, B, and C). The capital is held as follows: A, £10,000; B, £12,000; and C, £7,500. Interest at 5% is allowed upon capital and is charged on drawings, upon which there are no restrictions as to amount or date. C is entitled to be credited with a salary of £400 per annum. B lent £5,000 to the firm at 6% interest. All the partners withdrew goods from the firm for personal use.

In what form should the partners' accounts be recorded in the books of the firm?

Illustrate your answer by submitting a specimen of each kind of account you recommend the firm to employ. (*Royal Society Arts.*)

3. C and D were in partnership, C, who had money, providing £10,000 capital, and D, who had more experience, providing only £500. In addition, C had lent the firm £1,000 half-way through the year. There was no agreement between them beyond a verbal one that profits should be shared equally. The first year's trading resulted in a profit of £2,505. C contended that interest at the rate of 5% should be charged upon capital and upon the loan before dividing the profit.

Was he correct? If not, show how the profit should be dealt with and your reasons for dividing in the way you do. (*Chartered Accountants.*)

4. A and B are in partnership sharing profits in the proportion of two-thirds and one-third respectively. C, who is manager to the firm, and is in receipt of a salary of £1,000 a year, is taken into partnership and is given a quarter of the profits, A and B still sharing in the proportions of two and one. It is agreed between A and B that the latter shall not suffer in the amount he receives in the new partnership by reason of the fact that C now takes a share of profits instead of a salary. The profits of the firm are constant and may be assumed at £4,000 per annum after charging the manager's salary.

You are required to show the division of the profit under the new arrangement and to give the proportions in which profits should be divided for inclusion in the new partnership agreement. (*Chartered Accountants.*)

5. Scarlett and Lake join in partnership on January 1, without any formal deed between them. The capital introduced was as follows: Scarlett, £3,000; Lake, £2,000. On April 1 Lake advanced £500 to the firm as a loan without any agreement as to interest. The net profit for the half-year to June 30 is £2,500. The partners cannot agree on the following points: Interest on capital, interest on loan, division of profits. Prepare accounts on the lines that you would adopt, giving reasons for your action.

6. George and Hugh Dickson agree to admit George McArthur as a partner in their firm as on January 1.

The terms agreed upon were as follows: (*a*) McArthur was to pay £6,000 cash into the business, of which sum £1,800 was to be treated as a premium and divided as to two-thirds to George Dickson and one-third to Hugh Dickson. (*b*) In addition, McArthur was to bring in stock £3,000 and book debts £2,500. (*c*) Profits were to be divided: George Dickson, four-sevenths; Hugh Dickson, two-sevenths; and George McArthur, one-seventh.

The Balance Sheet of the old firm, as on the previous December 31, was as follows:—

BALANCE SHEET, DECEMBER 31.

	£		£
Capital—		Freehold Property	8,000
George Dickson	18,000	Machinery and Plant	19,500
Hugh Dickson	10,000	Sundry Debtors	8,740
Sundry Creditors	11,174	Stock	1,948
		Cash at Bank	986
	£39,174		£39,174

Prepare the Balance Sheet of the new firm as on January 1. (*Royal Society Arts.*)

7. A and B are partners, but no details have been agreed between them, verbally or by deed, other than the fact that profits are to be shared equally.

At the close of the year, B prepared the following Profit and Loss Account:—

PROFIT AND LOSS ACCOUNT.

		£		£
To 5% Interest on Capital—			By Balance from Trading Account . . .	1,885
A . . .	£250			
B . . .	150			
		400		
,, Salary, B . . .		200		
,, Interest at 5% on Loan from A . . .		75		
,, Balance carried down .		1,210		
		£1,885		£1,885
To A, ½ Share . . .		605	By Balance brought down .	1,210
,, B, ½ Share . . .		605		
		£1,210		£1,210

If you do not approve of this account, amend it. (*Royal Society Arts.*)

8. Submit a *pro-forma* Current Account showing: (*a*) Drawings and interest thereon; (*b*) Interest on Capital; (*c*) Partnership Salary; and (*d*) Share of Profits. (*Royal Society Arts.*)

9. A, B, and C are in partnership, sharing profits equally, and at March 31 their Capital Accounts were as follows: A, £8,000; B, £7,000; C, £6,000.

On April 1 they admitted D as an equal partner, he having agreed to bring in £5,000 as his capital and to pay the old partners £2,100 for goodwill. Each of the old partners was to leave one-half his share of the latter sum in the business, and to withdraw the other half.

Show the four partners' Capital Accounts as they will appear after the change, all payments having been made as agreed. (*London Chamber Commerce.*)

10. Explain, by means of specimen accounts, the best method of recording the accounts of partners in the books of the firm of which they are members.

In your answer deal with capital, drawings, loans, interest, and withdrawals of goods. (*London Chamber Commerce.*)

11. A, B, and C are in partnership upon the following terms: (1) Interest on capital is allowed at 5%. (2) Partners' monthly drawings are allowed as follows—A, £50; B, £40; C, £30. No interest is chargeable on these drawings. (3) Partner's salaries are B, £300 per annum; C, £200 per annum: these sums are to be credited to the respective current accounts at the close of each year. (4) Profits are to be shared as follows—A, four-sevenths; B, two-sevenths; C, one-seventh. (5) The fixed capital is as follows—A, £10,000; B, £6,000; C, £2,000. (6) It is agreed that half C's salary is to be debited to A.

Prior to any of the adjustments arising out of the above terms, the profits for the year ended December 31 last were £5,825.

Prepare the final section of the Profit and Loss Account, and the Partners' Accounts as on December 31 last. (*Royal Society Arts.*)

12. Hugh and George Dickson agree to admit William Robinson, their manager, into partnership as on January 1. Interest at 5% is allowed on capital, which is as follows: Hugh Dickson, £10,000; George Dickson, £5,000; William Robinson, £1,000.

Robinson is to be credited with a salary of £300 per annum, £200 of which is to be debited to Hugh Dickson and £100 to George Dickson. After providing for interest on capital, the profits are to be divided as follows: Hugh Dickson, four-ninths; George Dickson, three-ninths; William Robinson, two-ninths. No interest is charged on drawings, which were as follows: Hugh Dickson, £1,500; George Dickson, £800; William Robinson, £400.

The profit for the year ended December 31 amounted to £4,250 before making any of the above adjustments.

Give the partners' accounts as they would appear in the Balance Sheet as on December 31. (*Royal Society Arts.*)

13. McArthur and Chatenay are in partnership and share profits and losses as to two-thirds to McArthur and one-third to Chatenay. The capital is held as follows: McArthur, £12,000; Chatenay, £6,000. On December 31 the credit balances of the partners' current accounts were: McArthur, £1,800; Chatenay, £960.

On January 1 following, the firm admitted Pirrie into partnership on the following terms: Goodwill to be valued at £6,000 and to be credited to the capital accounts of the original partners. The current accounts to be transferred to the capital accounts. Pirrie to bring in, as capital, an amount equal to one-fourth of the total capital of the original partners as adjusted above.

Give the capital accounts as they would appear in the initial Balance Sheet of the new firm on January 1. (*Royal Society Arts.*)

14. Richard Black and William White enter into partnership, upon equal terms, for the purpose of purchasing and continuing the old-established business of the late Robert Blank. The business was taken over from Blank's executors as on January 1, as a going concern, upon the basis of the last certified Balance Sheet, which was as follows:—

R. Blank.

BALANCE SHEET, DECEMBER 31.

LIABILITIES.	£	ASSETS.	£
To Capital	26,593	By Freehold Premises .	14,200
,, Sundry Creditors . .	3,482	,, Plant Account . .	8,100
,, Reserve for Bad Debts .	385	,, Sundry Debtors . .	3,420
		,, Stock on hand . .	4,140
		,, Office Furniture . .	600
	£30,460		£30,460

The purchase price was agreed at £28,000, which amount was found, in equal shares, by Black and White, and duly paid over to Blank's executors.

In addition each partner paid £1,000 into the new firm's banking account to provide working capital, and it was agreed, before opening the new books, to reduce the valuation of the Plant (as shown above) by £500, the Stock by £450, and the Office Furniture by £200.

Make the opening entries necessary to record the above transactions in the books of the new firm, and draw up a Balance Sheet showing the position of Messrs. Black and White at the commencement of the new partnership. (*Chartered Accountants.*)

15. Jeeves and Wooster are partners, sharing profits and losses as to Jeeves two-thirds and Wooster one-third, and they agree to admit Bertie as a partner on June 1. Bertie is to bring in capital amounting to £3,000, and is also to pay £600 as premium, the latter to remain in the business. Show the entries you would make in the books of the firm.

16. At January 1, X, Y, and Z had the following respective capitals, viz. £3,330, £4,225, and £3,762. They shared profits in the ratio 3, 5, and 6. At that date they sold their assets for £9,177. They owed their creditors £208, and Y had advanced £555 on loan to the firm.

Prepare Balance Sheet, Realisation Account, Cash Account, and Partners' Capital Accounts.

17. X, Y, and Z were partners in a manufacturing business, sharing profits as follows: X, four-sevenths; Y, two-sevenths; Z, one-seventh.

Under a clause in the partnership deed, any partner was at liberty to retire and claim an annuity of £150 for each one-seventh share held by him in the profits; his share in the assets and goodwill to pass to the remaining partners in equal shares. Y retired from the firm on January 1, the amount standing to the credit of his capital account being £6,800.

How should you treat the annuity payable to Y, for the year ended on the preceding December 31? (*Royal Society Arts.*)

18. Jones and Webb, who are partners, sharing profits and losses as to five-eighths and three-eighths, admit Williams into partnership as from July 1. The Partnership Deed provides that Williams shall receive one-fifth of the net profits after allowing £400 salary and 4% interest on capital for each partner.

On July 1 following, it was ascertained that £4,000 net profit had been made before charging partners' salaries or interest on capital. The capital accounts were as follows: Jones, £6,000; Webb, £4,000; and Williams, £1,500.

Prepare Appropriation Account and Partners' Capital Accounts.

19. A and B are in partnership, sharing profits equally. As from December 31 they admit C, and from that date share: A, four-tenths; B, four-tenths; C, two-tenths. It is agreed that the Balance Sheet of A and B as on December 31 requires amendment as follows: Insurance Fund, credit balance, £1,780, is to be reduced to £280; Plant and Machinery are undervalued by £500; Provision for Bad Debts, £230, is to be increased to £400; J. Jones, debtor for goods supplied, £1,270, is to be written off as bad to the amount of £1,090, the difference of £180 being the surrender value of a life policy held as security, which is taken over by the new partnership.

Subject to these adjustments, C agrees to pay £2,000 for the acquisition of a two-tenths share in profits and goodwill.

Prepare Revaluation Account, adjusting the accounts as agreed, and show the treatment of the sum paid for Goodwill.

20. A and B are equal partners. In order to provide funds to pay out the executors of a deceased partner, a joint policy of assurance for £5,000 is taken out with the Northern Assurance Company. The sum assured is payable at the death of either partner. The annual premium is £450.

Show, by means of specimen entries, how the above transaction should be recorded in the books of the firm at the end of the first year after the assurance was effected. (*Royal Society Arts.*)

21. A firm has taken out life-assurance policies on the lives of the partners and the managers. How would you deal with the premiums in the accounts? Should they be shown as an accumulating asset in the Balance Sheet? Comment hereon.

22. T. Landry and R. Lambert, who were equal partners in a manufacturing business, agreed to dissolve partnership and to realise their business as on June 30. On that date their Balance Sheet was as follows:—

Messrs. T. Landry & R. Lambert.

BALANCE SHEET, JUNE 30.

LIABILITIES.	£	ASSETS.	£
T. Landry, Capital Account.	3,000	Sundry Assets	5,150
R. Lambert, Capital Account	700	Cash	850
Sundry Creditors . .	2,300		
	£6,000		£6,000

The expenses of the realisation, which were paid in cash, amounted to £270, and the Sundry Assets realised £3,920 in cash.

You are required to show fully the result of the realisation, which was concluded on August 16. Under the partnership articles, in the event of there being any deficiency on the capital account of either partner, the amount of such deficiency is to be at once made good in cash. (*London Chamber Commerce.*)

23. A. and B. Blank are partners. There is no partnership agreement.

The partnership was dissolved as on December 31, when the Balance Sheet was as follows:—

BALANCE SHEET, DECEMBER 31.

LIABILITIES.	£	ASSETS.	£
Capital—		Goodwill	2,500
A. Blank	10,000	Freehold Premises	10,000
B. Blank	5,000	Sundry Debtors	3,862
Sundry Creditors	3,714	Stock	2,480
Bank Overdraft	1,000	Cash in hand	10
		Cash at Bank	862
	£19,714		£19,714

The assets were realised as follows: Goodwill, £1,000; Freehold Premises, £12,500; Sundry Debtors, £2,972; Stock, £2,090. Allowances were obtained from creditors amounting to £270. The expenses of the dissolution amounted to £172.

Show the final result of the dissolution and the amounts payable to the partners. (*Chartered Institute Secretaries.*)

24. S, T, and U were partners sharing profits and losses equally. On the dissolution of the partnership on December 31, the Balance Sheet was as follows:—

	£		£
Sundry Creditors	8,000	Cash	800
Capital Account—		Sundry Debtors	4,200
S	2,500	Stock	6,000
T	2,000	Furniture and Fittings	300
U	1,000	Goodwill	2,200
	£13,500		£13,500

On realisation, Stock was sold at a discount of 30% on book values.

Sundry Debtors realised £3,500; Furniture and Fittings, £150; Goodwill, £450.

The expenses of realisation were £120.

Ascertain the deficiency and prepare accounts, showing the final position of each partner's capital after adjustment, consequent upon U being able to bring in only £250 towards his share of the deficiency. (*Incorporated Accountants.*)

25. George McArthur and Arthur Hadley were equal partners. McArthur died on December 30. Accounts were prepared at the close of the financial year (December 31), when it was found, after ascertaining and crediting the profit for the year in the ordinary way, that the partners' accounts stood as follows: McArthur, Capital Account, £8,000; Current Account (credit balance), £962. Hadley, Capital Account, £7,000; Current Account (credit balance), £852.

It was agreed with McArthur's Executors that the value of the goodwill, which had not hitherto appeared in the books, should be fixed at £3,000, and that the assets and liabilities should be reviewed. Valuations were made with the following results: The book value of the Plant and Machinery was reduced by £500; the Provision for Bad Debts was found to be excessive by £200; the Stock was undervalued by £350; the Sundry Creditors were overstated by £670; and the Patents (book value £300) were held to be of no value.

Submit the partners' accounts as they would appear in the Revaluation Balance Sheet.

26. On the dissolution of the partnership of N and O, the assets realised £17,500, subject to the cost of realisation, £250. The liabilities were: Overdraft at Bank, secured by a charge, £1,500; other Creditors, £6,500; Loan from N, £5,000; Capital, N, £5,000; Capital, O, £2,500; Loan from O, £1,000.

Profits and losses were to be shared in the proportion of two-thirds to N, one-third to O. State the order of priority in which the payments should be made, and show in account form how the cash realised would be distributed. (*Incorporated Accountants.*)

27. A, B, and C were in partnership and shared profits and losses in the proportions of one-half, one-third, and one-sixth respectively. They decided to dissolve partnership as on June 30. C was adjudicated a bankrupt during the realisation of the assets and was unable to contribute anything to his deficiency in the firm.

The partners' capitals were originally A, £10,000; B, £5,000; and C, £2,500; but were reduced to the figures appearing in the following Balance Sheet by adjustments made upon agreement between the partners at the end of the usual accounting periods.

BALANCE SHEET, JUNE 30.

	£		£
A, Capital Account	£7,000	Freehold Premises	4,200
B, Capital Account	2,000	Plant and Machinery	2,400
Sundry Creditors	5,650	Fixtures and Fittings	800
		Stock	2,600
		Sundry Debtors	3,500
		Cash	700
		C, Capital Account overdrawn	450
	£14,650		£14,650

The assets realised the following amounts: Freehold Premises, £4,500; Plant and Machinery, £1,900; Fixtures and Fittings, £500; Stock, £1,400; Sundry Debtors, £3,000.

The expenses of realisation were £300.

You are required to close the books of the firm. (*Chartered Accountants.*)

28. A and B were equal partners in a business from which A retired on December 31.

The Balance Sheet of the firm was then as follows:—

BALANCE SHEET, DECEMBER 31.

		£		£
Capital Accounts—			Plant and Fixtures	800
A	£5,100		Stock	3,600
B	2,600		Sundry Debtors	4,000
		7,700	Cash	1,500
Sundry Creditors		2,200		
		£9,900		£9,900

Under the Partnership Agreement, a partner retiring was entitled to be paid, for his share of the goodwill, two years' purchase of his share of the profits, based upon the average of the three years preceding his retirement. The profits of the firm for the last three years were £9,600.

Any bad debts incurred in the realisation of the debtors were to be taken as bad debts of the firm at the date of any retirement, but not so to affect the figures previously used for the calculation of the amount of goodwill. These amounted to £200.

It was agreed that A should be paid out, with interest at 5% per annum, by half-yearly instalments of £1,000 (covering interest and principal) until discharged, the first payment being made on June 30 following. So far as the debtors and creditors were concerned, interest was only to be calculated from the date of receipt or payment.

You are required to show A's account at the close of the year, assuming that the creditors were paid and the debtors realised at an average date of six months. (*Chartered Accountants.*)

29. X and Y are in partnership. The profits are shared as to three-fourths to X and one-fourth to Y.

The Balance Sheet of the firm, as on September 30, was as follows:—

	£		£
Capital—		Freehold Premises	20,000
X	18,000	Fixtures and Furniture	2,000
Y	6,000	Sundry Debtors	5,682
Creditors	4,600	Stock	4,334
Loan from X	4,000	Cash at Bank	1,984
Reserve Account	1,400		
	£34,000		£34,000

The partners decided to dissolve the firm and realise the assets.

X agreed to purchase the Freehold for £18,000, whilst Y took the Stock over at a discount of 15%. The book debts realised 94% of the Balance Sheet figure. The Fixtures and Furniture realised £1,742. The realisation expenses amounted to £784.

Give the accounts necessary to show the result of the realisation. (*Royal Society Arts.*)

30. In the firm of E and F, E is a general and F a limited partner. To the capital of the firm, which amounts to £25,000, F has contributed £5,000, and out of the profits is entitled to receive interest at the rate of 8% per annum, and one-tenth of the remaining profits. E is entitled on account of his share of the profits to draw £100 a month. At the end of the first year the following figures are extracted from the books of the firm:—

Capital Account, F, £5,000; Capital Account, E, £20,000; Creditors, £10,500; Debtors, £8,000; Land and Buildings, £13,500; Plant and Machinery, £7,500; Stock and Stores, £10,500; Cash, £2,400; E, Drawings Account, £1,200; F, Drawings Account, Interest, £400; Profit and Loss Account, £8,000.

From these figures draft Trial Balance and prepare accounts showing the profits due to each partner and the position of their accounts before the balance of profits respectively due is paid out. (*Incorporated Accountants.*)

31. A, B, and C are in partnership, sharing profits in the proportions of one-half, one-third, and one-sixth respectively. The X Company, Ltd., whose £1 shares have a market value of 23*s.* each, agrees to purchase the undertaking of A, B, and C (*excluding* cash), the consideration to be the taking over of the liabilities and the allotment of 10,000 shares in the company. The Balance Sheet of A, B, and C as on the date of purchase was:—

	£		£
Creditors	2,863	Goodwill	2,000
A, Capital	5,000	Plant and Machinery	4,782
A, Undrawn Profits	224	Debtors	3,168
B, Capital	4,000	Stock	2,715
B, Undrawn Profits	182	Cash	691
C, Capital	1,000		
C, Undrawn Profits	87		
	£13,356		£13,356

The partners agree amongst themselves that the balance of cash remaining after payment of their undrawn profits shall be divided equally between them, but they cannot agree as to the correct division of the shares. Prepare statements showing how in your opinion the shares should be divided, having regard to their market value. Ignore fractions. (*Chartered Accountants.*)

32. Bell and Broughton were in partnership sharing profits and losses as to three-fifths and two-fifths respectively. They decide to sell their business to the Lyte Engineering Company, Ltd., as at June 30, at which date their Balance Sheet was as follows:—

Bell & Broughton.

BALANCE SHEET, JUNE 30.

LIABILITIES.		£	ASSETS.		£
Capital—			Cash in hand	£50	
Bell	£15,000		Cash at Bank	500	
Broughton	10,000				550
		25,000	Sundry Debtors		14,450
Bell, Loan Account		2,500	Stock-in-Trade		18,000
Sundry Creditors		7,500	Plant and Machinery		6,000
Reserve Account		5,000	Fixtures, Fittings and Trade Utensils		1,000
		£40,000			£40,000

The Company agreed to purchase the Book Debts, Stock, Plant and Machinery, Fixtures, etc., and Goodwill, the consideration being £15,000 in cash and the allotment of 15,000 shares of £1 each in the Lyte Engineering Company, Ltd., which were quoted on the market at date of sale at a premium of £1 per share. The liabilities were paid by the partners. It was agreed as regards the purchase consideration that Broughton should receive half the shares in the Lyte Engineering Company, Ltd.

Prepare accounts showing the final settlement between the partners.

33. D, E, and F are equal partners, whose Balance Sheet at June 30, 19..., was as follows:—

LIABILITIES.	£	ASSETS.	£
D, Capital	20,000	Plant and Machinery	12,000
E, Capital	10,000	Trade Debtors	7,000
Trade Creditors	5,000	Stock-in-Trade	6,000
		F, Capital Account	5,000
		Freehold Property	5,000
	£35,000		£35,000

They dissolve the partnership. The assets upon sale realise £19,000, and the expenses amount to £1,000.

Following the rule in *Garner* v. *Murray*, you are required to close the accounts. (*Incorporated Accountants.*)

34. X and Y are in partnership, sharing profits and losses four-sevenths and three-sevenths respectively. Their Balance Sheet on December 31 was as follows:—

	£		£
Creditors	2,000	Goodwill	1,000
Capital, X	6,000	Property	4,000
Capital, Y	3,000	Debtors	4,000
		Cash	2,000
	£11,000		£11,000

Z joins them on January 1 following, it being agreed that he shall receive one-fifth share of profits, the shares of X and Y bearing the same relation to each other as heretofore.

Z's Balance Sheet is as follows:—

	£		£
Creditors	1,500	Property	2,000
Capital	2,000	Debtors	1,000
		Cash	500
	£3,500		£3,500

Before opening the books of the new partnership it is agreed that the following adjustments shall be made: X and Y—Value of property to be reduced by £1,000; a Provision equal to 5% on Debtors to be made; Goodwill to be increased or decreased to allow for these adjustments. Z—Value of property to be increased by £500; a Provision equal to 5% of Debtors to be made; Creditors to be increased to £1,700; a Goodwill Account of £1,000 to be raised and the balance of Z's Capital Account to be increased or decreased to allow for these adjustments.

Show the opening Balance Sheet of the new partnership, indicating the proportions in which X, Y, and Z will share in the profits and losses.

35. G. McArthur and C. Fitzgerald are in partnership upon the following terms: (*a*) The fixed capital of the partners is: McArthur, £15,000; Fitzgerald, £8,000. (*b*) 5% interest is allowed upon capital and charged upon drawings. (*c*) Profits are shared—McArthur, two-thirds; Fitzgerald, one-third. (*d*) The goodwill of the business stands in the books at £5,000, and McArthur is to be credited with 2½% as interest on this amount and Profit and Loss Account debited. (*e*) The partners are entitled to draw each year on the last day of March, June, September, and December as follows—McArthur, £480; Fitzgerald, £240. (*f*) Fitzgerald is to be credited, at the close of each year, with £500 as salary. £100 of this amount is to be debited to McArthur's current account, and the balance to Profit and Loss Account. (*g*) During the year goods were supplied from stock as follows—McArthur, £196; Fitzgerald, £85; but no entries have yet been made in the books.

You are to assume that all the above conditions have been complied with and the necessary entries made in the books.

In addition to the accounts arising out of the above, the following balances were extracted from the books of the firm as on December 31; Stock, £32,480; Freehold Warehouse, £5,640; Fixtures and Fittings, £960; Additions and Alterations (Warehouse), £1,000; Sales, £98,462; Purchases, £62,462; Returns (Sales), £324; Returns (Purchases), £941; Rates and Taxes (Warehouse, £1,141; Office, £136), £1,277; Lighting and Heating (Warehouse, £385; Office, £95), £480; Bank Overdraft, £2,067; Cash in hand, £108; Sundry Creditors, £9,796; Sundry Debtors, £7,860; Investment (5% Debentures), £2,000; Bills Payable, £2,142; Bills Receivable, £1,241; Warehouse Expenses, £1,557; Warehouse Wages, £4,872; Provision for Bad Debts (January 1), £250; Insurance (Warehouse, £486; Office, £38), £524; Interest Account (Credit Balance), £61; Carriage Outwards, £948; Carriage Inwards, £794; National Health Insurance (Warehouse), £84; Fixtures and Fittings sold during the year, £200; Office Furniture, £760; Vans and Horses, £1,572; Office Salaries, £2,104.

You are required to prepare Trading and Profit and Loss Accounts for the year ended December 31, and a Balance Sheet as on that date.

When preparing these accounts the following matters must be taken into consideration: (1) The error in the Trial Balance (£38) must be carried to a " Difference in the Books Account." (2) The quarter's interest (5%) on the investment to December 31 has accrued due, but has not been paid or passed through the books. (3) Write off the following depreciations—Fixtures and Fittings, 15%; Office Furniture, 5%. (4) The following items were outstanding at the close of the year, and no entries had been made in the books—Warehouse Wages accrued, £98; Office Salaries accrued, £46; Insurance (Warehouse) paid in advance, £121. (5) Provide 5% for bad debts on the Sundry Debtors. (6) Write off one-half of the additions and alterations to warehouse. (7) The following valuations were made as on December 31: Stock, £21,846; Vans and Horses, £1,400. (*Royal Society—Advanced.*)

36. Peter Pink and Benjamin Brown are in partnership, sharing profits and losses, two-thirds and one-third respectively. Interest on capital at 5% is to be credited to the partners annually. The Trial Balance of their books at December 31, 19..., is as follows:—

	£	£
P. Pink—		
Capital Account		3,600
Current Account Balance, January 1, 19...		120
Drawing Account	1,004	
B. Brown—		
Capital Account		1,600
Current Account Balance, January 1, 19...		80
Drawing Account	847	
Office Furniture	840	
Sundry Debtors and Creditors	2,934	854
Purchases and Sales	37,060	43,021
Stock, January 1, 19...	1,880	
Carriage Inwards	292	
Returns Inwards and Outwards	125	220
Rent	375	
Salaries	630	
Carriage Outwards	56	
Discounts		331
Provision for Bad Debts		500
Advertising	800	
Rates	180	
Insurance	62	
Insurance, National	27	
Telephone	26	
General Expenses	133	
Printing and Stationery	64	
Postage	117	
Repairs	21	
Electric Light	18	
Bank Charges	6	
Investment: £1,600 5% Railway Stock at cost	1,557	
Interest on Investments		31
Cash at Bank	1,293	
Cash in hand	10	
	£50,357	£50,357

The Stock at December 31, 19..., is valued at £1,287.

Prepare Trading and Profit and Loss Accounts for the year ended December 31, 19..., and Balance Sheet at that date after making the following adjustments;

one quarter's rent is outstanding: rates unexpired, £36; Insurance unexpired, £21; six months' interest accrued on Investment (less Income Tax at 4*s.* 6*d.*); carry forward one-half of the amount spent on Advertising; write off Bad Debts, £67; depreciate Office Furniture at 5% per annum.

37. The firm of Markham and Newbold (architects), to which you have been appointed secretary, has a capital of £5,000 provided as follows: G. Markham, £3,000; Alfred Newbold, £2,000, on which 5% interest is to be credited to the partner's current accounts annually.

The figures, other than those representing capital and interest, contained in the Trial Balance of the books at December 31, 19..., are as follows: Rent, £600; Sundry Debtors, £1,800; G. Markham, Current Account, credit balance, £740; A. Newbold, Current Account, credit balance, £360; Apprenticeship Premiums, £1,200; Sundry Creditors, £270; G. Markham, Drawings, £1,100; A. Newbold, Drawings, £800; Salaries, £2,200; Professional Fees, £5,797; Furniture, £1,290; Investments, £2,500; Interest on Investments, £125; Telephone, £40; Cash at Bank, £2,350; Cash in hand, £20; Electric Light, £42; Printing and Stationery, £211; Drawing Materials, £270; Prints and Photos, £260; Miscellaneous Expenses, £9.

Prepare final accounts for the year ended December 31, 19... The following adjustments are necessary: Apprenticeship Premiums were for five years; four years to run from the commencement of the current year. Only three quarters' rent charged, one quarter due. Stock of Stationery in hand = £130.

38. The firm of M and N consisted, on June 30, of two partners, sharing profits in the proportions of four-sevenths and three-sevenths respectively. The Balance Sheet at that date showed:—

	£		£
Capital Account, M	8,000	Land and Buildings	3,500
Capital Account, N	6,000	Plant and Machinery	5,250
Creditors	7,500	Furniture and Fixtures	800
Profits not drawn	1,400	Stocks and Stores	5,700
		Debtors	6,600
		Cash	1,050
	£22,900		£22,900

It is agreed to admit O into partnership on July 1, on payment of £2,100 for goodwill, divisible between M and N in the proportions in which they provided capital and divided profits. O also brings in £4,000 capital. One-half the profits not drawn on June 30 are to be divided between M and N in their respective proportions, the balance to remain in the business and to be credited in the same proportions to M and N's Capital Accounts. It is agreed that the Stock and Stores shall be reduced in value to £5,000, and that the reduction shall be charged to the Capital Accounts of M and N in the proportion of four-sevenths and three-sevenths. M, N, and O are to divide profits in proportion to their respective capital accounts as on July 1. Show the respective Capital Accounts of the three partners as at that date, and state the proportions in which they will divide profits. Set out the Balance Sheet of the new firm as at July 1. (*Incorporated Accountants.*)

39. O. Fitzgerald carried on business as a manufacturer of rubber heels and sundries. On January 1 he agreed to admit C. Testout as a junior partner on the following terms:—

A Goodwill Account of £3,000 was to be opened, and a similar amount credited to Fitzgerald's Capital Account. Fitzgerald was to draw £40 per month, and Testout £30 per month. No interest was to be charged on drawings, but 5% interest was to be allowed on capital. Testout was to pay in £3,000 in cash as his capital. Testout was to be credited with a salary of £250. Profits were to be shared as to two-thirds to Fitzgerald and one-third to Testout.

On December 31 the undermentioned Trial Balance was extracted from the books of the firm:—

TRIAL BALANCE, DECEMBER 31.

	£	£
O. Fitzgerald—		
Capital Account		9,000
Drawings Account	480	
C. Testout—		
Capital Account		3,000
Drawings Account	110	
Goodwill	3,000	
Partnership Salary	250	
Plant and Machinery	2,840	
Loose Tools	520	
Sales		27,580
Sales Returns	108	
Purchases	9,684	
Purchases Returns		312
Machinery Repairs	349	
Stock (January 1)	3,872	
Bad Debts	221	
Provision for Bad Debts (January 1)		400
Carriage Inwards	462	
Carriage Outwards	524	
Office Salaries	1,948	
Office Expenses	362	
Travellers' Salaries and Commission	1,486	
Factory Power	1,642	
Bills Receivable	325	
Factory Wages	4,894	
Rent and Rates (Factory)	1,278	
Rent and Rates (Office)	163	
Factory Expenses	821	
Insurance (Factory)	248	
Insurance (Office)	29	
Discount Account		84
Cash at Bank	464	
Bank Overdraft		4,000
Sundry Creditors		3,206
Sundry Debtors	9,862	
Office Furniture	240	
Motor Lorry	1,400	
	£47,582	£47,582

You are required to prepare a Factory Working Account and a Profit and Loss Account for the year ended December 31, and a Balance Sheet as on that date.

When preparing these accounts, the following matters must be taken into consideration: (*a*) The following depreciations are to be written off—Plant and Machinery, 10%; Office Furniture, 5%; Motor Lorry, 20%; Loose Tools, 15%. (*b*) Sundry Loose Tools were made by the firm's workmen, and Wages £92 and Purchases £28 are to be transferred from these accounts to Loose Tools Account before calculating the above depreciation. (*c*) The Stock in hand, as on December 31, was valued at £4,092. (*d*) The Provision for bad debts is to be made up to £500.

40. A, B, and C were in partnership in a manufacturing and trading concern under the style of A B & Co., sharing profits and losses in the proportions of 8, 6, and 1. Interest was to be at the rate of 6% per annum on partners' capitals and at the rate of 5% per annum on Current Accounts.

Drawings are made quarterly by equal instalments on September 30, December 31, March 31, and June 30. The following is a summary of the Current Accounts of the several partners for the year ended June 30, 1950:—

	A	B	C
	£	£	£
Balance (Cr.), June 30, 1949	840	153	110
Profit and Interest for the year to June 30, 1949, credited as on September 30, 1949 .	2,070	1,545	252
	2,910	1,698	362
Less Drawings	2,500	2,000	300
	£410	Dr. £302	£62

The following Trial Balance was extracted from the books of the firm as on June 30, 1950:—

TRIAL BALANCE, JUNE 30, 1950.

	£	s.	d.	£	s.	d.
Capital, June 30, 1949—						
A				25,000	0	0
B				20,000	0	0
C				4,000	0	0
B, Capital withdrawn March 31, 1950 . .	1,000	0	0			
Current Accounts, June 30, 1950—						
A				410	0	0
B	302	0	0			
C				62	0	0
Machinery, June 30, 1949	7,095	10	0			
Machinery, Additions since	300	0	0			
Investments	2,015	0	0			
Bad Debt Provision, June 30, 1949 . . .				250	0	0
Bad Debts	263	8	6			
Office Furniture	550	0	0			
Motor Lorry	390	0	0			
Rent, Factory	1,200	0	0			
Rent, Office	275	0	0			
Power, Factory	510	15	9			
Heating and Lighting, Factory	73	4	2			
Heating and Lighting, Office	39	5	9			
Expenses, Office and Factory	473	6	6			
Goodwill	5,000	0	0			
Interest on Investments				100	0	0
Stock, June 30, 1949	15,797	8	6			
Sundry Debtors and Creditors	4,411	1	10	3,571	0	0
Wages	14,105	14	0			
Machinery Repairs	509	10	0			
Discount	330	8	8			
Salaries and Comissions	1,809	5	0			
Purchases	39,106	17	3			
Sales				42,507	13	2
Cash at Bank	317	7	5			
Cash in hand	25	9	10			
	£95,900	13	2	£95,900	13	2

You are required to prepare Trading and Profit and Loss Accounts for the year ended June 30, 1950, and a Balance Sheet as on that date. In preparing these accounts adjustments are to be made in accordance with the following instructions: (*a*) The Stock valuation on June 30, 1950, was £34,486 19*s.* 2*d.* (*b*) The Bad Debt Provision is to be made up to £300. (*c*) One-sixth of the Expenses is to be charged to the Office and the remainder to the Factory. (*d*) The following had accrued and were unpaid at June 30: Wages, £224 13*s.*; Salaries, £134 5*s.* (*e*) Depreciation is to be charged as follows: Machinery, Old, 7½%; New, 5%; Furniture, 10%; Motor Lorry, one-third.

41. A firm of resin manufacturers, A. B. and C. D., trading together as equal partners, agree that in the event of the death of one of the partners the survivor shall pay out the interest of the deceased partner and purchase his share, the purchase price to be the profits of the three preceding completed years.

A. B. died on October 1. The Stock at that date was valued at £1,800, and the net profits for the three preceding completed years were as follows: £3,500, £2,100, and £1,523.

The following figures as at date of death were extracted from the books of the firm: A. B., Capital Account, Amount at Credit, £2,000; C. D., Capital Account, Amount at Credit, £2,000; A. B., Drawing Account, in Debit, £300; C. D., Drawing Account, in Debit, £200; Salaries, £575; Rent and Rates, £250; Stock January 1st, £1,500; Wages, £1,210; Sales, £11,000; Purchases, £7,100; Returns, Outwards, £150; Sundry Debtors, £2,400; Trade Creditors, £2,100; Cash at Bank, £1,665; Petty Cash overdrawn, £10; Office Furniture and Fixtures, £100; Discounts Received, £220; Discounts Allowed, £250; Plant and Machinery, £1,750; General Expenses, £250.

You are required to prepare the necessary accounts to produce to the executors of A. B. showing what is due to his estate. The Partnership Deed provided that the assets should be taken at their book value. (*Incorporated Accountants.*)

CHAPTER VIII

CONSIGNMENT ACCOUNTS. JOINT VENTURE ACCOUNTS

I. CONSIGNMENT ACCOUNTS.

A CONSIDERABLE part of the export and import trade of this country consists of goods sent on consignment to British agents by foreign manufacturers and exporters, or by British manufacturers and exporters to foreign agents. The book-keeping records of consignments are based upon ordinary double-entry methods, but special application of these methods is necessary, owing to the fact that the property in goods sent on consignment remains in the consignor or shipper until actua sale of the goods is effected.

Definitions.—In book-keeping terminology, goods sent by a principal to his agent for sale on behalf of the principal are termed a *consignment*. They are *Consignments Outwards* from the point of view of the principal, and *Consignments Inwards* from the point of view of the agent. Consignments usually involve some element of speculation The principal in these transactions is termed the *consignor*; the agent is the *consignee*. Subject to any agreement between the parties, a consignee may pledge his principal's goods, give valid receipts upon sale of them either for cash or on credit, and exercise a lien upon them for any unpaid commission or expenses incurred by him in connection with the goods.

A consignee is remunerated for his services as agent by an agreed *commission* charged by him to his principal. This commission usually takes the form of a percentage on the gross proceeds of sale of the goods consigned. Where the consignee guarantees his principal against loss from bad debts, an additional commission, called a *Del Credere Commission*, is paid to him. In some cases, these two commissions are merged into one percentage.

The statement rendered by the consignee to the consignor, containing detailed particulars of the consignment, and detailed particulars of sales, expenses, and commission, and showing the net amount due to the consignor, is termed an *Account Sales* (A S). A specimen Account Sales is shown on p. 248.

It is usual for the principal to forward to the agent a formal invoice for the goods termed a *Pro Forma Invoice*. This is merely a memorandum for the guidance of the agent, giving a description of the goods—weight, quantity, quality, shipping marks, etc.—and sometimes also stating a minimum or reserve selling price for the goods.

The all-important point to note in connection with consignment accounts is that, upon shipment of the goods, *no sale has taken place and consequently no debtor exists. The consignee becomes a debtor only when he has sold the goods, either in whole or in part.* Indeed, the consignee may never become a debtor at all, since, being an agent, he may return the goods to the consignor, if he fails to sell them. Hence the need for the special book-keeping methods employed.

The records of outward consignments deal with the despatch of the goods, and the expenses connected therewith, such as packing, freight, insurance, etc. The accounts are closed by incorporating the information furnished by the Account Sales rendered by the consignee upon sale of the goods. Finally, therefore, the consignor's books record a complete history of the consignment, viz. details of the consignment, the expenses incurred thereon both by consignor and consignee, the commission charged by the consignee, and the net proceeds of sale. The records of inward consignments show details of the goods, the sales effected and their proceeds, the expenses incurred, the commission charged, the net proceeds of sale, and the remittance or remittances made to the consignor.

Where consignments are numerous, it is usual to keep a separate set of books for their service. These would consist of: A Consignment Ledger, a Cash Book, and an Account Sales Book. Consignment Accounts have a good deal in common with Branch Accounts.

It is a frequent practice for the consignor to draw a bill of exchange upon the consignee for a part of the value of the goods consigned, *e.g.* 75% of the value. The bill would be drawn at the time of shipment, and made payable at such a period after sight as will give the consignee time to dispose of the goods. The consignor may then attach the shipping documents to the bill and obtain an advance upon the bill from his banker.

Consignments Outwards.—Consignor's Books.—It has already been stated that goods sent on consignment remain the legal property of the consignor until sold. For this reason it is clear that he cannot debit their value to the personal account of the consignee. An account is therefore opened under the caption "Consignment to X"—the consignee's name being inserted. This account is debited with the cost of the goods consigned. A second account, called "Consignments Outwards Account," is credited with a like amount, and, at the close of a financial period, is finally closed by transfer to the consignor's Trading Account. In cases where the goods are invoiced to the consignee at a value above cost, it is essential that the profit thus anticipated shall not find its way to the Trading Account. As in the case of Branch Accounts, this is avoided either by (1) using two columns in the Consignments Outwards Journal (which contains details of all consignments), for (*a*) cost price, and (*b*) invoice price, the cost-price column only being posted, or, should this be impracticable, then (2) by eliminating the profit by debiting Consignments Outwards Account, and crediting Consignment to X Account with the excess of the invoice price over cost price. An Adjustment Account, similar to that used in the case of Branch Accounts, may be employed, but its use is cumbersome, and is not recommended.

Any expenses incurred by the consignor in despatching the goods, insuring them, etc., will be debited to the Consignment to X Account, Cash or the appropriate creditors' accounts being credited.

If a bill is drawn on the consignee at the time the goods are despatched, the personal account will be credited, and Bills Receivable Account debited. Any further entries will have to await receipt of the Account Sales from the Consignee. From the information contained in the Account Sales, the Consignment to X Account will be credited and the consignee debited with the gross proceeds realised by sale of the goods. The consignee will be credited and the Consignment to X Account will be debited with the expenses incurred and the commission charged by the consignee.

Should the consignee remit by draft, he will be credited and Bills Receivable Account be debited.

When all the goods have been sold, the Consignment to X Account is closed by transferring the balance (the net profit or net loss) to Profit and Loss Account. If the account is closed off before all the goods have been sold, the stock must first be inserted at cost price (or market price if lower, the local market price being taken) on the credit side, and brought down as a debit balance to the next financial period. When valuing stock, it is permissible to include any expenses incurred, such as freight, insurance, etc., in so far as they can be attributed to the portion unsold. As regards the consignor's expenses, these will usually relate to the whole consignment, including those goods already sold, and a simple apportionment will be necessary. But, in dealing with the consignee's expenses, all those relating solely to goods sold must be ignored when valuing stock, and that portion only relating to the goods unsold must be included.

Where practicable, quantity accounts will be kept to check the stock unsold at any date.

When preparing the Consignor's Balance Sheet, the important point to keep in view is that all unsold consignments must be treated strictly as *stock*, and so valued.

Consignments Inwards.—Consignee's Books.—The consignee makes no entry in his financial books on receipt of the goods, although he will no doubt need some descriptive memoranda of quantities received, etc. His one obligation is to account to the consignor for the proceeds of any sales effected, less expenses, disbursements, commission, etc. Thus the only additional account necessary is a personal account for the consignor, which is credited with the proceeds of sales (cash, or debtors being debited) and debited with expenses and remittances (cash, creditors, or bills payable being credited). The consignee will calculate his commission (usually a percentage on gross sales) and will debit the consignor's account therewith, crediting his own Profit and Loss (or Commission Earned) Account.

From the following example, it will be seen that the effect of the system outlined above is to eliminate the cost of goods sent on consignment from the Trading Account and to credit Profit and Loss Account with the net proceeds of sale.

Illustration.—Jacobs & Co. of Manchester consigned 20 cases of goods to their agents, Denny & Co. of Durban, invoiced *pro forma* as of a value of £1,250 (being cost plus 25%). Jacobs & Co. paid freight, insurance, etc., £45, and drew on Denny & Co. at 90 d/s for £1,000. They discounted the bill at a charge of £22. An Account Sales was received in due course from the consignees showing gross proceeds of sale, £1,525. The A/S was accompanied by a draft for the balance after the following items had been deducted: Commission, 6¼% + 1% *del credere*; landing and dock charges, storages, etc., £20. Show the records of these transactions as they would appear in the books both of consignors and consignees, and submit an Account Sales in the usual form.

ACCOUNT SALES 20 cases of goods received from Jacobs & Co., Manchester, per s.s. *Colestown*, sold by Denny & Co., Durban.

		£	s.	d.	£	s.	d.
	15 cases @ £70 . .	1,050	0	0			
	5 cases @ £95 . .	475	0	0			
					1,525	0	0
JACOBS & Co. 217/236	*Less*— Landing and dock charges, storage, etc. . . .	20	0	0			
	Commission, 6¼% on £1,525	95	6	3			
	Del credere, 1% on £1,525 .	15	5	0			
					130	11	3
					1,394	8	9
	Less Draft accepted against consignment .				1,000	0	0
	Sight Draft herewith on Chartered Bank of South Africa				£394	8	9

E. & O.E.
DURBAN.
January 15, 19...

per pro. DENNY & Co.
JAMES ABERNETHY,
Accountant.

Note.—In actual practice, interest is frequently charged on disbursements from the date of their occurrence to the date of the Account Sales.

JACOBS & CO.'S BOOKS.

CONSIGNMENT TO DENNY & CO., DURBAN.

Dr.		£	s.	d.			£	s.	d. Cr.
19...	To Goods on Consignment Account .	1,250	0	0	19...	By Consignee—Gross Proceeds . .	1,525	0	0
	,, Cash, Freight, Insurance, etc. .	45	0	0		,, Goods on Consignment Account, adjustment of invoice price .	250	0	0
	,, Consignee's Account:								
	Landing Charges, etc. . . .	20	0	0					
	Commission, 6¼% .	95	6	3					
	Del Credere, 1% .	15	5	0					
		1,425	11	3					
	,, Profit and Loss Account . . .	349	8	9					
		£1,775	0	0			£1,775	0	0

DENNY & CO., DURBAN.

Dr.		£	s.	d.			£	s.	d. Cr.
19...	To Consignment Account, Gross Proceeds . . .	1,525	0	0	19...	By Bills Receivable .	1,000	0	0
						,, Consignment Account:			
						Landing Charges, etc. . .	20	0	0
						Commission, 6¼%	95	6	3
						Del Credere, 1%	15	5	0
						,, Bills Receivable .	394	8	9
		£1,525	0	0			£1,525	0	0

GOODS ON CONSIGNMENT OUTWARDS.

Dr.									Cr.
		£	s.	d.			£	s.	d.
19...	To Consignment Account (to reduce to cost) . . .	250	0	0	19...	By Consignment Account . .	1,250	0	0
	„ Trading Account .	1,000	0	0					
		£1,250	0	0			£1,250	0	0

BILLS RECEIVABLE ACCOUNT.

Dr.									Cr.
		£	s.	d.			£	s.	d.
19...	To Denny & Co. . .	1,000	0	0	19...	By Cash	978	0	0
						„ Discount on Bills Account . .	22	0	0
		£1,000	0	0			£1,000	0	0
19...	To Denny & Co. . .	394	8	9					

DENNY & CO.'S BOOKS.

JACOBS & CO., MANCHESTER, *re* CONSIGNMENT INWARDS *ex* S.S. *Colestown*.

Dr.									Cr.
		£	s.	d.			£	s.	d.
19...	To Cash. Landing Charges, etc. .	20	0	0	19...	By Sundries (Cash or Debtors), Proceeds of Sales .	1,525	0	0
	„ Commission Account . . .	95	6	3					
	„ *Del credere* Commission Account .	15	5	0					
	„ Bills Payable . .	1,000	0	0					
	„ Bills Payable . .	394	8	9					
		£1,525	0	0			£1,525	0	0

EXAMINATION QUESTIONS.

1. On June 1, 19..., the Niger Coal Co., Ltd., consigned to Niger Sales, Ltd., in Illyria, 2,000 tons of coal invoiced at 20*s.* a ton. The pit cost of the coal and the rail freight (including wagon hire) to the port were 15*s.* and 4*s.* a ton respectively.

On June 25 an Account Sales was received from the Sales Company showing 1,000 tons sold at 32*s.* a ton; Ocean freight paid, 8*s.* a ton; Dock dues and demurrage, £88; Insurance, £12; Brokerage, 1½%; and Commission, 2½%. The consignees enclosed a bill for the proceeds, less expenses, and reported a shortage of weight of 40 tons on the whole consignment.

Show the necessary accounts in the books of the Niger Coal Co., Ltd.

2. Alexanders & Co., wool brokers, sell " by order and on account and risk of " Pontifex & Rees, *ex Bendigo* at Australia, the following wool :—

Marks.	Lot.	Bales.	Gross Weight.			Tare and Draft.			
			c.	qr.	lb.	c.	qr.	lb.	
◇	89	25	89	2	4	3	2	0	at 2*s.* 2*d.* lb.
J.S.C.	90	28	101	3	2	3	2	15	at 1*s.* 11½*d.* lb.

Set out the Account Sales in proper form. N.B.—The candidate is himself to specify the various charges likely to be deducted from the gross proceeds, and to allot purely nominal amounts for each item, showing finally the net proceeds. (*Royal Society Arts.*)

3. T. Russell, a colonial merchant with an office in London, is an agent for Messrs. Hall & Jones, of Christchurch, New Zealand, exporters of Canterbury lamb, etc. Included in the latter's 19... season's shipments is a consignment of 7,000 carcases (2,500 lambs and 4,500 sheep) shipped per s.s. *Achilles*. Mr. Russell disposed of the whole of this consignment, obtaining orders as under at the prices stated:—

1,500 Lambs, weighing 50,000 lb. at 7*s*. per stone at 8 lb. c.i.f.
1,000 Lambs, weighing 34,000 lb. at 6*s*. 9*d*. per stone of 8 lb. c.i.f.
2,500 Sheep, weighing 140,000 lb. at 7*d*. per lb. *ex* store.
2,000 Sheep, weighing 110,000 lb. at 6*d*. per lb. delivered.

The charges paid in London in connection with this consignment were as under:—

	£	s.	d.
Marine Insurance	161	2	4
Fire Insurance.	2	10	1
Storage Charges	78	1	9
Port Rates	3	10	0
Cartage	9	1	11
Claims	49	16	4

Messrs. Hall & Jones drew a bill on their London agent at thirty days' sight for £10,000 which was duly honoured at maturity. Prepare an Account Sales of the consignment referred to, providing for London agent's commission at the rate of 1% on the gross proceeds.

Record all the transactions in the books of the consignee, opening the necessary accounts. (*Incorporated Accountants.*)

4. A acts as *del credere* agent for B. In A's books, which are made up to June 30, 19..., you find the following accounts:—

CONSIGNMENT INWARDS ACCOUNT.

	£		£
To B, 10,000 bales . .	5,000	By Sundry Debtors, 5,000 bales sold . .	2,700
,, Cash, Expenses of consignment . . .	150	,, Balance . . .	3,366
,, Commission, 8% of £2,700 . . .	216		
,, Bad Debts incurred on Consignment Account	700		
	£6,066		£6,066

B.

		£		£
To Cash—5,000 bales sold . .	£2,700		By Balance . . .	246
Less Expenses and Commission . .	850		,, Consignment Account .	5,000
Transmitted .		1,850		
,, Balance . . .		3,396		
		£5,246		£5,246

A asks how these accounts should be treated in his annual accounts, made up to June 30, 19... What answer would you give, and what suggestions would you make? *(Chartered Accountants.)*

5. On May 1, 19..., A, of London, ships on consignment to B, of Cape Town, for sale by the latter upon A's account, 50 cases of goods invoiced *pro forma* at £10 a case. A commission of 3% is payable to B upon sales, and all charges are borne by the consignor.

A pays freight and insurance in London amounting to £34, and draws upon B at three months' sight for £300 against the shipment.

B sells for cash 10 cases at £12 a case on July 1, 19..., 25 cases at £13 10s., a case on July 15, and the balance on July 25 at £13 a case, having accepted A's draft on June 1, 19.... He forwards an Account Sales to A on July 16, deducting the commission due and charges incurred, such charges amounting to £27 for landing, storage, etc., and remits a draft for the balance.

You are required to prepare the Account Sales and to show how the transactions would appear in the consignor's books. *(Chartered Secretaries.)*

II. JOINT VENTURES.

Definition.—A joint adventure is a partnership limited to a particular trading operation or speculation. Such features of an ordinary partnership as firm-name, and continuity of business relationship, are absent from a joint venture. The legal relationship between joint venturers has not yet been clearly defined, but Lord Eldon once said that " a joint adventure is as proper a partnership as any other." Each adventurer contributes capital in agreed proportions, and shares the profit or loss from the adventure in agreed proportions. The close of the adventure terminates the partnership relationship.

Joint adventures usually relate to the purchase and sale of goods, but they may, of course, be entered into for speculative purposes, *e.g.* dealing in stocks and shares, or exchange operations, underwriting, etc.

Book-keeping Treatment.—If a separate set of books is kept for the venture, and a separate banking account opened, the natural method of book-keeping is precisely similar to that laid down for an ordinary partnership and no further explanation is necessary. If, as is more likely, one or both of the parties is a trader and the venture is merely an incidental side line or special transaction entered into in the course of his business, no special bank account being opened but any receipts or payments in the course of the venture being passed through the trader's ordinary banking account, somewhat special treatment is necessary.

Where there are only two parties to the venture, two alternative methods of treatment are possible. The first method is to open a " Joint Venture Account " in the form of a memorandum statement, outside the double-entry books, from which is determined the total profit on the venture and its division between the parties. In the books themselves is opened a single account, headed " Joint Venture with X " or similarly, and to this account are posted all cash receipts and payments (and possibly other transactions) affecting the trader in whose books the entries are made, the other party's receipts and payments being ignored. When the venture is complete and the profit has been ascertained the trader's own share of profit (only) is debited to the Venture Account and credited to his Profit and Loss Account. Any balance then remaining on the Venture Account then represents a sum payable to or receivable from the other party, and on the passing of a cheque for the amount in question the account is closed. The Joint Venture Account, used in this manner, is theoretically a mixture of a nominal account and a personal account: in practice, as can be seen from what has been said, it is treated just as though it were a personal account.

Under the second method, two accounts are opened in the books, one being a "Joint Venture Account" in which are entered all detailed transactions of *both* parties entered into in the course of the venture (strictly a nominal account) and the other a personal account headed with the name of the other party. If both parties keep books, both can keep their records, independently, by either of the two above methods. If there are three parties to the venture, as sometimes happens, it will be best if one, at least, of them keeps a full detailed record in his books, using the second method and writing up a separate personal account for each of the other two parties; otherwise confusion is likely to arise.

If interim accounts for the joint venture are prepared, under the first method the goods or other assets in question must be carried down as a debit balance on the memorandum Joint Venture Account, thus enabling a figure of interim profit to be ascertained. If the goods are in the possession of the trader who is preparing the account the amount must also be brought down on the Joint Venture Account in the books; if, however, they are in the other party's possession this should not be done. The interim share of profit can be debited in the Joint Venture Account, but it is easily seen that the balance on the account does not at this stage represent an amount due by one party to the other.

If interest is computed as between the joint venturers, the individual Joint Venture Accounts are treated in a similar manner to Accounts Current, interest on the items composing the accounts being debited or credited at the rate agreed.

Rules for Joint Venture Accounts Under the First Method.

(*a*) Each venturer must open in his books a Joint Venture Account, and must treat it as a personal account, debiting all payments, charges, interest, etc., and crediting all receipts and other credit items.

(*b*) When the venture is concluded, each venturer must send a copy of his personal account to each of his co-venturers.

(*c*) From the separate personal accounts, a combined Profit and Loss Account must be prepared showing the profit to be received, or the loss to be borne, by each venturer.

(*d*) The venturers from whom balances are due must remit those balances in cash to those venturers to whom they are due, thus closing the respective accounts of all the venturers.

Illustration.—Black and White enter into a joint transaction in Government surplus stores. Black acquires a million yards of linen at 6*d* per yard on January 1, 19..., and pays cash therefor (plus carriage), £25,040. It is agreed that he shall be allowed £100 per month for warehousing charges, office expenses, etc. White sends Black a bill for £10,000 dated January 1, at 1 month (without days of grace). White pays advertising expenses, £500, on February 1. Black discounts the bill on January 1, discounting charges (to be borne by the venture) being £35. Settlement is to be made every 3 months, until completion of the venture. Interest, computed in months, is to be taken at 6%. Profits or Losses are to be shared: Black, three-fifths; White, two-fifths.

Sales were as follows:—

3 months to March 31: Black, 200,000 yd., £10,000.
White, 300,000 yd., £16,875.

Each party collected the cash for their own sales; the due date of the receipts may be taken as March 1 in each case.

3 months to June 30th: Black, 150,000 yd., £6,562.
White, 350,000 yd., £17,500.
Due date in each case May 1.

White charged sundry expenses in the 3 months to March 31, £60, and for the 3 months to June 30th, £75.

Stock is to be valued at 6*d.* per yard.

Black purchased a Motor Delivery van on February 1, at a cost of £500, valued as on March 31 at £400. Black agreed to take this van over as on June 30, at a valuation of £200.

Note.—In the illustration, the accounts of the joint venture in the books of Black and of White are ruled off at March 31 and June 30, to indicate the entries made in the accounts before and after the combined Joint Venture Account has been prepared.

The solution of the illustration, using the first method, is set out on pp. 257–259. If the second method is used, the Joint Venture Account, as set out in memorandum form on p. 259, will appear as an actual account in the books of either Black or White (or both, according to whether it is the books of Black, or White, that are in question), though the postings and the wording used against the various entries will differ slightly and the sales by Black (a cash posting in Black's books but a posting to Black's personal account in White's, and vice versa) must be shown separately from the sales by White. In Black's books, however, instead of the "Joint Venture with White" set out on p. 257 there will appear a personal account with White as set out on p. 254; and conversely, in White's books, instead of the account on p. 258 there will appear a personal account with Black as set out on p. 255.

Two points arising in this illustration are worthy of particular note.

(1) The treatment in each solution of the unsold stock and the motor van at the date when an interim balance is struck. It should be noted that in each case the provisional settlement between the parties is on the basis that these assets are being financed by Black. It is assumed that this is as agreed; of course, it need not necessarily be so. In real transactions each case would have to be dealt with according to whatever agreement was reached. In the second method of solution the basis assumed results in a credit balance equal to the amount involved being carried down on Black's personal account in White's books. In Black's books, on the other hand, there is a (debit) balance on the Joint Venture Account only, and no balance appears on White's account after the provisional cash settlement. This corresponds to recognition of the fact that the assets in question are treated as the property of, or as being financed by, Black.

(2) The treatment of interest. Under either method, if all interest (whether debit or credit) is posted to interest account, a result will be

Black's Books (SECOND METHOD).

WHITE PERSONAL ACCOUNT.

Dr.		Mths.	Interest.									Mths.	Interest.					Cr.
			£	s.	d.	£	s.	d.					£	s.	d.	£	s.	d.
19... Mar. 31	To Venture Account, Sales (as Mar. 1)	1	84	7	6	16,875	0	0	19... Jan. 1	By Bill Receivable Feb. 1		2	100	0	0	10,000	0	0
,, 31	,, Interest					84	7	6	Mar. 31	,, Profit to date						5,234	14	0
										,, Cash						1,059	13	6
									Feb. 1	,, Venture Account, Advertising Charge		2	5	0	0	500	0	0
									Mar. 3	,, Interest						105	0	0
										,, Venture Sundry Expenses						60	0	0
						£16,959	7	6								£16,959	7	6
June 30	To Venture Account, Sales (as May 1)	2	175	0	0	17,500	0	0	June 30	By Venture Account, Sundry Expenses						75	0	0
	,, Interest					175	0	0		,, Balance of Profit						4,413	1	0
										,, Cash						13,186	19	0
						£17,675	0	0								£17,675	0	0

White's Books (Second Method).

BLACK PERSONAL ACCOUNT.

Dr.

		Mths.	Interest.					
19...			£	s.	d.	£	s.	d.
Jan. 1	To Bill Payable	2	100	0	0	10,000	0	0
Mar. 31	,, Venture Account, Sales (as Mar. 1)	1	50	0	0	10,000	0	0
,, 31	,, Cash					1,059	13	6
,, 31	,, Interest					150	0	0
,, 31	,, Balances carried down:							
	Stock					12,500	0	0
	Motor Van					400	0	0
						£34,109	13	6
June 30	To Venture Account Sales (as May 1)	2	65	12	5	6,562	0	0
,, 30	,, Interest					65	12	5
,, 30	,, Venture Account, Motor Van taken over					200	0	0
	,, Cash, to Balance					13,186	19	0
						£20,014	11	5

Cr.

		Mths.	Interest.					
19...			£	s.	d.	£	s.	d.
Jan. 1	By Venture Account:							
	Purchase of Linen	3	375	12	0	25,040	0	0
,, 1	Discounting charges	3		10	6	35	0	0
,, 31	Warehousing, etc.	2	1	0	0	100	0	0
Feb. 1	Motor Van	2	5	0	0	500	0	0
,, 28	Warehousing, etc.	1		10	0	100	0	0
Mar. 31	Do.					100	0	0
	,, Interest					382	12	6
	,, Venture Account, Profit to date					7,852	1	0
						£34,109	13	6
Apr. 1	By Balances brought down:							
	Stock	3	187	10	0	12,500	0	0
	Motor Van	3	6	0	0	400	0	0
,, 30	,, Venture Account, Warehousing, etc.	2	1	0	0	100	0	0
May 31	,, Do.	1		10	0	100	0	0
June 30	,, Do.					100	0	0
,, 30	,, Interest					195	0	0
,, 30	,, Venture Account, Balance of profit					6,619	11	5
						£20,014	11	5

shown which is correct from the point of view of double entry. It should be recognised, however, that so far as such interest charges appear in the Joint Venture Account (that is, all of them except interest on direct payments by one party to the other) they represent interest on the capital temporarily employed in the venture and the balance, which must necessarily be represented by a debit in the Joint Venture Account, goes to reduce the apparent divisible profit on the venture. It thus really represents an appropriation of part of the profit on the venture, exactly like interest on partner's capital in an ordinary partnership. It will be instructive to analyse the result from the point of view of one of the partners (say Black) in the foregoing illustration. The entries in Black's interest account may be summarised thus:—

		Debit.			Credit.			Balance (credit).		
		£	s.	d.	£	s.	d.	£	s.	d.
Mar. 31	From Venture Account	134	7	6	387	12	6			
	From White	105	0	0	84	7	6			
		£239	7	6	£472	0	0	232	12	6
June 30	From Venture Account	240	12	5	195	0	0			
	From White				175	0	0			
		£240	12	5	£370	0	0	£129	7	7
	Total credit balance							£387	12	6

and Black's total share of profit, including interest, will be:—

		£	s.	d.	£	s.	d.
Mar. 31	Share of profit per Venture Account	7,852	1	0			
	Interest (as above)	232	12	6	8,084	13	6
June 30	Share of profit per Venture Account	6,619	11	5			
	Interest	129	7	6	6,748	18	11
					£14,833	12	5

If the trader in question (Black in this case) enters into more than one venture during the year, or if profits are ascertained (as in the illustration) at interim dates before the final close of the venture, it will be advisable to open a "Profit on Joint Ventures Account" to which all such profits are posted in the first instance, and it will be informative if all interest charged in connection with the ventures is posted also to the same account. If this method were followed in the illustration the balance shown on the account would clearly be £14,833 12*s.* 5*d.*, as computed above.

EXAMINATION QUESTIONS.

1. Baker and Brown are partners in a joint venture in connection with a cargo of goods offered by Stone & Co., on the basis that Baker is to buy and sell, and for such services, receive 5% of the net profits, if any; the remaining profits, or the loss, to be divided as to Baker four-sevenths and Brown three-sevenths.

JOINT VENTURE WITH WHITE.

Dr. Cr.

Date		Mths.	Interest. £	s.	d.	£	s.	d.	Date		Mths.	Interest. £	s.	d.	£	s.	d.
19... Jan. 1	To Cash, Purchase of Linen, and Carriage	3	375	12	0	25,040	0	0	19... Jan. 1	By Bill Receivable, due Feb. 1	2	100	0	0	10,000	0	0
" 1	" Discounting Charges	3		10	6	35	0	0	Mar. 1	" Cash (Sales)	1	50	0	0	10,000	0	0
" 31	" Warehousing and Office Expenses	2	1	0	0	100	0	0	" 31	" Interest					150	0	0
Feb. 1	" Motor Delivery Van	2	5	0	0	500	0	0	" 31	" Balance carried down					6,107	12	6
" 28	" Warehousing and Office Expenses	1		10	0	100	0	0									
Mar. 31	" Warehousing and Office Expenses					100	0	0									
" 31	" Interest					382	12	6									
						£26,257	12	6							£26,257	12	6
19... Mar. 31	To Balance brought down					6,107	12	6	19... Mar. 31	By Stock carried down					12,500	0	0
" 31	" Profit and Loss Account, profit to date					7,852	1	0	" 31	" Motor Van at valuation					400	0	0
									" 31	" Cash from White					1,059	13	6
						£13,959	13	6							£13,959	13	6
19... Apr. 1	To Stock brought down	3	187	10	0	12,500	0	0	19... May 1	By Cash (Sales)	2	65	12	5	6,562	0	0
" 1	" Motor Van	3	6	0	0	400	0	0	June 30	" Interest					65	12	5
" 30	" Warehousing and Office Expenses	2	1	0	0	100	0	0	" 30	" Balance carried down					6,767	7	7
May 30	" Warehousing and Office Expenses	1		10	0	100	0	0									
June 30	" Warehousing and Office Expenses					100	0	0									
" 30	" Interest					195	0	0									
						£13,395	0	0							£13,395	0	0
19... June 30	To Balance brought down					6,767	7	7	19... June 30	By Motor Van taken over					200	0	0
" 30	" Profit and Loss Account, profit to date					6,619	11	5	" 30	" Cash from White					13,186	19	0
						£13,386	19	0							£13,386	19	0

Vhite's Books.

JOINT VENTURE WITH BLACK.

Dr.		Mths.	Interest.								Mths.	Interest.					Cr.
			£	s.	d.	£	s.	d.				£	s.	d.	£	s.	d.
19...									19...								
an. 1	To Bill Payable, due Feb. 1	[illegible]	100	0	0	10,000	0	0	Mar. 1	By Cash (Sales)	1	84	7	6	16,875	0	0
eb. 1	,, Cash, Advertising Charges	2	5	0	0	500	0	0	,, 31	,, Interest					84	7	6
Iar. 31	,, Sundry Expenses					60	0	0									
,, 31	,, Interest					105	0	0									
,, 31	,, Balance carried down					6,294	7	6									
						£16,959	7	6							£16,959	7	6
19...									19...								
Iar. 31	To Profit and Loss Account, profit to date					5,234	14	0	Mar. 31	By Balance brought down					6,294	7	6
,, 31	,, Cash to Black					1,059	13	6									
						£6,294	7	6							£6,294	7	6
19...									19...								
June 30	To Sundry Expenses					75	0	0	May 1	By Cash (Sales)	2	175	0	0	17,500	0	0
,, 30	,, Balance carried down					17,600	0	0	June 30	,, Interest					175	0	0
						£17,675	0	0							£17,675	0	0
19...									19...								
June 30	To Profit and Loss Account, profit to date					4,413	1	0	June 30	By Balance brought down					17,600	0	0
,, 30	,, Cash to Black					13,186	19	0									
						£17,600	0	0							£17,600	0	0

Black and White.

JOINT ADVENTURE IN LINEN.

Memorandum statement only, not forming part of the double entry in the books of either Black or White.

Dr.																	Cr.
		Mths.	Interest. £	s.	d.	£	s.	d.			Mths.	Interest. £	s.	d.	£	s.	d.
19... an. 1	To Purchase of Linen and Carriage	3	375	12	0	25,040	0	0	19... Mar. 1	By Sales, 500,000 yd.	1	134	7	6	26,875	0	0
,, 1	,, Discounting Charges	3		10	6	35	0	0	,, 31	,, Stock, 500,000 yd. at 6*d.*					12,500	0	0
, 31	,, Warehousing and Office Expenses	2	1	0	0	100	0	0	,, 31	,, Motor Van at valuation					400	0	0
eb. 1	,, Advertising Expenses	2	5	0	0	500	0	0	,, 31	,, Interest (Balance to contra)		253	5	0			
, 1	,, Purchase of Motor Van	2	5	0	0	500	0	0									
, 28	,, Warehousing and Office Expenses	1				100	0	0									
ar. 31	,, Warehousing and Office Expenses					100	0	0									
, 31	,, Sundry Expenses					60	0	0									
, 31	,, Interest (Balance from contra)					253	5	0									
						26,688	5	0									
31	,, Profit: Black, ⅗ths					7,852	1	0									
	White, ⅖ths					5,234	14	0									
			£387	12	6	£39,775	0	0				£387	12	6	£39,775	0	0
9... r. 1	To Stock, 500,000 yd. at 6*d.*	3	187	10	0	12,500	0	0	19... May 1	By Sales, 500,000 yd.	2	240	12	5	24,062	0	0
1	,, Motor Van	3	6	0	0	400	0	0	June 30	,, Motor Van					200	0	0
30	,, Warehousing and Office Expenses	2	1	0	0	100	0	0	,, 30	,, Interest (Balance from contra)					45	12	5
y 31	,, Warehousing and Office Expenses	1		10	0	100	0	0									
ne 30	,, Warehousing and Office Expenses					100	0	0									
30	,, Sundry Expenses					75	0	0									
30	,, Interest (Balance to contra)		45	12	5												
						13,275	0	0									
30	,, Profit: Black, ⅗ths					6,619	11	5									
	White, ⅖ths					4,413	1	0									
			£240	12	5	£24,307	12	5				£240	12	5	£24,307	12	5

The following are the transactions: 19... May 1, Bought from Stone & Co. Goods T.60, £60,000; May 2, Brown handed to Baker, £5,000; May 4, Pai Stone & Co., on account, £6,000; May 9, Parker Bros., paid on account, £10,000 May 10, Sold Goods to Parker Bros., T.20, £25,000; May 11, Sold Goods to River & Co., T.30, £33,000; Parker Bros. returned damaged goods, T.1, £1,250; Ma 15, Sold Goods to Rivers & Co., T.9, £11,000; May 26, Received from Parke Bros., £13,750; May 27, Paid Stone & Co., £12,000; May 28, Sold for Cash, T.2 £750; Received from Rivers & Co., £44,000; May 30, Paid Stone & Co., £42,000 Out of Pockets charged by Baker, £100; May 31, Baker paid Brown balance du to him.

Make the necessary entries in Baker's books and prepare a general statemen showing the result of the venture. (*Institute Book-keepers.*)

2. Black and White entered into partnership upon equal terms as to profits o losses of the venture, for the purpose of perfecting an invention with a view to it sale to a Syndicate. No interest was to be paid upon Partners' Capital prior t division of results. Black contributed £300 and White £150 to cover the cost c experiments, White giving his personal services without salary.

Upon the completion of the necessary experiments the purchases and expense were found to have amounted to £478. Black then advanced a further £50, an White paid £22 for Patent fees, etc.

The invention was sold by them to a Syndicate for £1,000 in cash, which wa paid to them, and 1,000 fully paid shares of £1 each in the Syndicate, and thes were duly allotted.

Upon dissolving the partnership, White arranged to take over the stock c materials at an agreed valuation of £36, and undertook to discharge outstandin liabilities (if any). Black consented to take over the £1,000 fully paid shares a an agreed valuation of £50.

Prepare the accounts necessary upon the dissolution of partnership. (*Roy Society of Arts.*)

3. Mr. John Black and Mr. Edward Thompson agree to import Swedis timber into this country. On May 1, 19..., they open a Banking Account unde the style of "Black & Thompson" for £2,400, towards which John Black contr butes £1,400 and Edward Thompson £1,000, they dividing profits or losses *pro rat* to their cash contributions (say, seven-twelfths and five-twelfths respectively They remit to their agent in Sweden £1,800 to pay for the timber purchased ou there, and, later on, a further £100 in settlement of his account. The Freigh Insurance, and Dock Charges are all paid on this side, and, together, amount t £400. On December 31, 19..., the various sales have realised £2,400 net, whic enables them to repay themselves (taking no account of interest) the cash r spectively advanced by them on May 1, 19... The venture is then closed b John Black taking over the balance of timber unsold for £380, and for which h pays a cheque into the Banking Account. How much Cash Balance does th leave for final division by way of profit, and how is the same apportioned betwee John Black and Edward Thompson as their respective share of profit thus realise on the venture? (*Institute of Bankers.*)

4. Brown and Jones engage in a joint speculation in timber, the former bei in Russia and the latter in England. A banking account in their joint names opened on February 10, 19... Brown pays in £500 and Jones £660. The follo ing are the transactions: 19... February 15, Bought cargo in Riga from Sandherr valued £632, less discount at 5%, £600 8s.; Accepted Sandherr's dra at 3 m/d, £600 8s.; February 17, Paid expenses loading at Riga, £28 9s. 6d Paid freight to Hull, £68 17s. 6d.; March 23, Sold Robinson logs, £165 18s Received cash, less 5%, £157 12s. 2d.; March 24, Bought from M. Reimann f cash cargo of timber, net £633; April 20, Paid shipping charges and freight, £21 April 24, Sold M. Johnson deals, net £337; Received his acceptance at 2 month £337; May 17, Sold J. James cargo purchased from Reimann, net £1,260; R ceived his acceptance at 1 month, £1,260; June 30, Stock, balance of Sandher cargo, valued at £311. On June 30 the speculation was closed by Jones taki over the stock at the agreed value of £311, less 10%. Adjust the accounts between the partners at June 30, 19..., allowing interest on the amounts deposit at 5%.

CHAPTER IX

LIMITED COMPANIES

COMPANY FORMATION

[*Note.*—All references are to the Companies Act, 1948 unless otherwi stated.]

THE trading records of Incorporated Companies, whatever the particula business carried on, are precisely the same as those of sole traders, c partners conducting similar businesses. Apart, however, from th usual commercial books of account, there are, in the case of companie certain books and registers which need to be specially considerec Some of these books and registers are obligatory under statute, whil others, as will be explained later, are convenient in use and save time

Definition.—An Incorporated Company consists of a body of person united for certain definite purposes under royal or legislativ sanction, in such manner that they form a corporate body, *i.e.* a entity recognised in law as a distinct legal personality capable o holding property in its own right, of incurring obligations, and o suing and being sued in its own name. Subject to its Memorandun and Articles of Association, a Limited Company has the same contractual powers as a firm or private person.

Methods of Incorporation.—Companies may be incorporated in on of three ways, viz. by

(*a*) *Royal Charter.*—This method is, nowadays, rarely adopted except in the case of companies formed for Colonial development. The East India Company (1600) and The Hudson's Bay Company (1670) were incorporated under Royal Charter. A modern example is The British South Africa Company (1889).

(*b*) *Special Act of Parliament.*—The Bank of England (1694) and such undertakings as the British Railways afford examples of this mode of incorporation.

(*c*) *Registration under "The Companies Acts."* *

As on December 31, 1949, there were on the Register 12,075 Public Companies, having an aggregate paid-up capital of £3,854,000,000 and 231,482 private companies having an aggregate paid-up capital of £2,094,000,000. The total paid-up capital of all companies was thus slightly under £6,000,000,000.

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* The first of the Company Acts of Parliament was passed in the year 1844. In 1855, the principle of limiting the liability of the members of a joint-stock company incorporated by registration was introduced. The first great Company Consolidation

Kinds of Incorporated Companies.—There are three classes of Incorporated Companies, viz.:—

(*a*) Companies limited by *Shares*.

(*b*) Companies limited by *guarantee* (with or without a share capital).

(*c*) Companies the liability of whose members is *unlimited* (with or without a share capital).

In class (*b*) the Memorandum of Association limits the liability of the members to the definite amount which each undertakes to contribute to the assets in the event of the liquidation of the company while he is a member, or within one year of his having ceased to be a member (S. 2 [3]). In class (*c*) no limit is attached to the liability of the members. Both these classes, (*b*) and (*c*), are quite unsuitable for commercial undertakings, and are so seldom met with that no further consideration will be given to them in this volume. It is with the formation and administration of companies limited by shares, class (*a*), that this and the succeeding chapters are concerned, for the vast majority of incorporated companies in existence to-day are so limited.

Advantages of Registration.—Registration as a Company confers many advantages not possessed by a firm or sole trader. Registration facilitates the raising of fresh capital, increases financial resources, and so enhances credit, expedites extensions and amalgamations, and permits arrangements to be made for employees to acquire an interest in the business. The death or bankruptcy of members does not affect a company's existence, neither does the transfer of its shares from one person to another. Doubtless, however, the most popular advantage is the limitation of the liability of the members with the ensuing protection of their personal estates. Briefly stated, no member of a company limited by shares can be called upon to contribute any sum beyond the nominal value of the shares he has agreed to take. When once he has paid the full nominal value of the shares for which he has subscribed, he is entirely relieved from any further claim to contribute towards the company's liabilities. He may lose the capital he has invested should the company fail, but no matter how involved in debt the company may become the amount of his subscription to the capital fund marks the limit of his liability.*

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sixteen amending Acts were passed. The provisions of those Acts, known as "The Companies Acts, 1862–1908," were, with additions and amendments, re-enacted in the great Consolidation Statute of 1908. Three further amending Acts were passed which, with the Act of 1908, were known as "The Companies Acts, 1908–1917." In 1928 an important amending act came into force and was quickly followed by the Companies Act, 1929: this was a consolidating Act combining the new provisions of the 1928 Act with the earlier legislation. In 1947 came the Companies Act, 1947, which introduced a number of new provisions, many of which were of great importance. Before these provisions actually took effect, however (with a few exceptions), the whole of the existing legislation (including all the provisions of the Act of 1947) was consolidated by the Companies Act, 1948, and this came into full force on July 1, 1948.

* The liability of the members of a limited company carrying on the business of banking, and issuing notes, is, in respect of the note issue, unlimited.

Illustration.—On April 1, Rayon d'Or, Ltd., offered for public subscription 100,000 ordinary shares of £1 each, payable as to 5*s.* per share on application, 5*s.* per share on allotment, and 10*s.* per share on May 1. On April 2, George Dickson sent in an application for 100 shares together with his cheque for £25 (5*s.* per share application money). On April 5, the 100 shares were allotted to him, and on the day following he forwarded a further £25 (5*s.* per share allotment money). On May 1, he forwarded £50, being the final call of 10*s.* per share. George Dickson's liability on the dates mentioned was as follows:—

April 5. £75, *i.e.* £100 less £25 application money paid.
April 6. £50, *i.e.* £75 less £25 allotment money paid.
May 1. Nil, the balance of £50 having then been paid.

However unfortunate the history of Rayon d'Or, Ltd., may subsequently prove to be, no further claim can be made against George Dickson, since he has paid for his 100 shares in full.

The only events in which the shareholders' liability may become unlimited are:—

(*a*) If at any time the number of members of a company is reduced, in the case of a private company, below two, or, in the case of any other company, below seven, and it carries on business for more than six months while the number is so reduced, every member of the company during the time that it so carries on business after those six months who is cognisant of the fact of the reduction in membership below two or seven as the case may be shall be severally liable for the payment of the whole debts of the company contracted during that time (S. 32).

(*b*) Under S. 202, the liability of directors, managers, or managing directors may be unlimited if so provided by the memorandum—a seldom-used provision.

The idea, at one time prevalent, that registration as a limited company would adversely affect the credit of the undertaking has largely died out. There is no doubt that in earlier days dishonest people converted their businesses into limited companies in order to escape their liabilities. Usually, the consideration money took the form of debentures, and the claims of unsecured creditors were thus defeated. In several cases, *e.g.* *In re* Hirth [1899] and *In re* Goldburg [1912], such schemes were held to be fraudulent conversions, or acts of bankruptcy, and the practice was killed. Registration places information at the disposal of the public through the documents filed * at Bush House, and a solvent business gains rather than loses the confidence of its creditors from the easy access to the filed documents.

Company Contrasted with Firm.—It may be useful to set out in tabular form the main distinctions between a company limited by shares and a partnership.

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* The word "filed" is employed to mean "delivered to the Registrar of Companies for registration."

Partnership.	*Limited Company.*
(*a*) The partners in a firm are individuals acting together in partnership as they may mutually agree amongst themselves, or, in the absence of agreement, in accordance with the Partnership Act, 1890, or agreement may be implied by a course of dealing. If they so desire, partners may vary the terms of the Act in certain respects. The capital of a firm may be increased or decreased by agreement between the partners, or by trading gains or losses. A firm is not in England a separate entity, although in Scotland it is. The members of a partnership may not exceed twenty in number, and if the business carried on be banking they may not exceed ten.	(*a*) A company is a legal entity itself, distinct from the members w hold shares in it. It is governed the Act of 1948, which it cannot ove ride. Its powers are determined by Memorandum of Association, and c be altered only by sanction of the Cou Its capital is fixed by its Memorandu and cannot be altered except under t powers conferred by Statute. The is no limit to the number of shar holders (except in private companie but the statutory minimum number shareholders must be maintained, i seven in a public and two in a priva company.
(*b*) The liability of a partner (except a limited partner) is co-extensive with the whole of his property. Every partner in a firm is jointly liable with his co-partners (in Scotland severally also) for all the debts and obligations of the firm incurred while he is a partner. Judgment obtained against a firm is judgment against all the partners of the firm jointly.	(*b*) The liability of a shareholder limited to the amount which he h agreed to contribute to the capital the company, and when he has pa that amount to the company, further liability attaches to hi Judgment against a company is n judgment against the shareholders in vidually, but against the company its corporate capacity.
(*c*) All partners (except limited partners) can take part in the management of the business of the firm; and all have access to its books. A partner can bind the firm and his co-partners so long as he acts within the ordinary scope of the business, or within the special authority delegated to him by his co-partners. He is an agent of the firm and his co-partners for the purposes of the business of the partnership. A limited partner, however, can only "advise," for, if he takes any part in the management of the business, he becomes liable as a general partner.	(*c*) A shareholder has no power bind the company, or to bind his shareholders; nor has he any right take part in the management of t company, or to inspect its books, exce as may be allowed by the Articles. T conduct of a company's business volves upon the Directors. The a of the Directors are governed by t Articles of the company, and th cannot be altered except by spec resolution passed by the sharehold in general meeting. A shareholde influence is confined to his vote on t occasion of ordinary or extraordina general meetings convened by t Directors, or in certain cases provid by Statute, by the members the selves, if the directors default in calli such meetings.
(*d*) A partner cannot, except by agreement with his co-partners, substitute another partner for himself. A limited partner, however, cannot prevent a general partner from transferring his share. The death, bankruptcy, or retirement of a partner (where these events do not result in the winding-up of the partnership), or the bringing in of a new partner, has the effect of creating a new firm.	(*d*) A shareholder can transfer shares as he pleases, subject to t Articles of Association, which, in t case of a private company, must restr transfers. No matter what chan may occur in the personnel of t shareholders of a company, the c poration remains the same entity.

(*e*) It is not obligatory on a firm to appoint auditors or to hold meetings.	(*e*) A limited company must annually appoint auditors, and must hold certain meetings.
(*f*) Partners can make any agreement they choose, and can vary the terms of the partnership when and as they please.	(*f*) Companies are bound by their Memorandum and Articles, and though the latter may be varied there are some things not allowed, *e.g.* the company may not buy its own shares.
(*g*) There is no Statutory provision requiring a partnership to keep books of account, although it is practically essential, and the failure to keep books may be an offence if the firm becomes bankrupt.	(*g*) A limited company must keep proper books of account, and prepare a Profit and Loss (or Income and Expenditure) Account and Balance Sheet every year. Severe penalties attach to default in this respect.
(*h*) A partnership can be brought to an end by agreement at any time.	(*h*) A limited company can be brought to an end only by being struck off the Register by order of the Court or where it has ceased to function, or by being wound up by the Statutory Process.

Statutory (or Parliamentary) Company.—These companies are quite distinct from Companies incorporated under the Companies Acts. They are incorporated by Acts of Parliament specially passed for the regulation of certain classes of enterprises, the majority of which are formed for the purpose of undertaking work of a public character. They are not required to add the word "Limited" to their names, and are not bound to permit inspection of their share registers as other Companies are. But they must keep open for inspection without charge a Shareholders' Address Book. Table A does not apply to these companies, which are governed by the somewhat antiquated regulations contained in the various Companies Clauses Consolidation Acts, 1845–1899, so far as the special acts of the undertakings do not exclude or modify them.

Forming a Company.—Any *seven* or more persons may combine to form and register a *public* company; any *two* or more may form and register a *private* company.

No partnership of more than *ten* persons shall be formed to carry on the business of banking unless it is incorporated (S. 429); and no partnership of more than *twenty* persons shall be formed for carrying on any other business that has for its object the acquisition of gain unless it is incorporated, or is a company engaged in working mines within the Stannaries [mines in Devon and Cornwall], and subject to the jurisdiction of the court exercising the Stannaries jurisdiction (S. 434).

If a company continues to trade after its membership has fallen below seven in the case of a public company and two in the case of a private company, penalties attach to the remaining members, and the company may be wound up (S. 222 (*d*)).

Usual Procedure in Formation of Company.—The usual steps in the formation of a public company limited by shares are to prepare: (1) The Memorandum of Association, and the Articles of Association.

(2) The preliminary contracts. (3) A statement of the nominal capital. (4) A list of the persons who have consented to act as directors. (5) Where the directors are appointed by the Articles they must, either personally or by an agent authorised in writing, sign and file (*a*) a written consent to act as directors, and (*b*) if they have not signed the Memorandum for their qualification shares they must sign a contract to take and pay for the necessary shares (S. 181). (6) The statutory declaration that all the requirements of the Act have been complied with.

All the above documents must be duly signed and stamped and lodged with the Registrar of Companies, who, if satisfied that everything is in order, issues, on the second official day after the fees and duties are paid, a certificate that the company is incorporated and is limited. From the date of incorporation mentioned in the certificate, the subscribers to the Memorandum, and all other persons who may from time to time become members of the company, are a body corporate having perpetual succession and a common seal but with such liability to contribute to the assets of the company in the event of its being wound up as is mentioned in the Act (S. 13). The company has also power to hold lands (S. 14).

The next step is to obtain the necessary capital. This is effected by the preparation and issue of a *Prospectus*, containing such particulars as are required by the Act, inviting the public to subscribe for the whole of the company's share capital or debentures, or part thereof. The prospectus cannot be issued until a copy signed by each Director or proposed Director named therein has been duly filed with the Registrar.[*]

Should the issue prove successful, *i.e.* should: (*a*) the amount stated in the Prospectus as the *minimum subscription* upon which the directors may proceed to allotment be taken up by the public, and (*b*) the amount payable on application on each share, which must not be less than 5% of the nominal value of each share, has been paid to and received by the company, then the directors may proceed to allotment (S. 47).

A public company which does not issue a prospectus, or which has issued a prospectus but has not proceeded to allot any of the shares offered to the public for subscription, must at least three days before the first allotment of any of its shares or debentures file with the Registrar a *Statement in Lieu of Prospectus* signed by every director or proposed director of the company in the form and containing the particulars set out in the Fifth Schedule to the Act (S. 48).

The company having been duly incorporated and the required capital having been subscribed by the public, a statutory declaration must be filed that: (*a*) the minimum subscription[†] has been allotted, and that (*b*) every director has paid to the company in cash the same proportion per share on the shares taken or contracted to be taken by him for cash as is payable by the public per share on application and allotment, or in the case of a public company not issuing a Prospectus on the shares payable in cash. Thereupon, the Registrar shall certify that the company is entitled to commence business and the certificate shall be conclusive evidence of the fact (S. 109).

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[*] In order to save time, the prospectus is sometimes registered prior to incorporation.

[†] The statutory declaration filed by a company which has filed a statement in lieu of prospectus does not refer to "minimum subscription," which applies only to companies issuing a prospectus.

A public company may simultaneously issue both shares and debentures. The provisions as to minimum subscription apply only to a first allotment of shares offered to the public for subscription and not at all to a debenture issue. But in the case of a second or subsequent offer of shares, the amount offered for subscription on each previous allotment made within the two preceding years, and the amount actually allotted, and the amount, if any, paid on the shares so allotted must be stated in the prospectus (Fourth Schedule, Part I, 6).

Public Company.—The expression " Public Company " occurs nowhere in the Acts, and is not a statutory term: as used in practice it simply means any company which is not a " Private Company," and all the provisions of the Companies Act apply to *all* companies except in so far as the Act may state as regards particular provisions, that they are not to apply to a private company. Although only seven members are necessary to form a public company, the number of members may be increased to any extent, so long as the total amount of the shares issued by a company does not exceed the total capital which it is authorised to issue by its Memorandum of Association.

Private Company.—Section 28 defines a private company as one which by its Articles of Association :—

(*a*) restricts the right to transfer its shares; and

(*b*) limits the number of its members to fifty, not including persons who are in the employment of the company and persons who, having been formerly in the employment of the company, were while in such employment, and *have continued* after the determination of that employment, to be members of the company; and

(*c*) prohibits any invitation to the public to subscribe for any shares or debentures of the company.

The documents required on registration of a private company are: (1) Memorandum, (2) Articles, (3) Statement of Nominal Capital, (4) Statutory Declaration.

Every private company must send with the annual return required to be filed under S. 126, a certificate signed by a director and the secretary that the company has not, since the date of the last return, or in the case of a first return since the date of incorporation, issued any invitation to the public to subscribe for any shares or debentures of the company; and, *where the return of members discloses the fact that* the number of members of the company exceeds fifty, also a certificate to certify that such excess consists wholly of persons who are to be excluded in reckoning the number of fifty (S. 128).

Two persons suffice to form a private company in place of the *seven* required for a public company. If a private company alters its

Articles so that they no longer include the provisions which constitute it a private company, it immediately ceases to be a private company, and must file a prospectus or a statement in lieu of prospectus within fourteen days of the alteration. (The form of statement in lieu is set out in the Third Schedule.) If a private company fails to comply with the provisions of its Articles of Association which confer upon it the privileges of a private company it ceases to be entitled to the exceptions granted by the Act, though, where the failure was inadvertent, the Court has power to relieve the company from its consequences (S. 30).

Joint holders of shares in a private company count as one person (S. 28 (2)).

Private companies are extremely popular, especially in connection with "family" businesses. By registering such a business as a company, the owner can enjoy the advantages of a partnership without its attendant risks of unlimited liability. He can admit his employees to a share in the business, and can divide his capital amongst the members of his family without disturbing the financial arrangements of the business, or burdening the beneficiaries with unlimited liability.

A private company enjoys certain privileges which are not shared by a public company. Exactly what those privileges are depends on whether or not the company, in addition to being "private," fulfils the conditions laid down by the Act for an "Exempt Private Company" (see below). The following exemptions apply to *all* private companies, whether "exempt" or not:—

(*a*) It need not file a prospectus or statement in lieu of prospectus (S. 48 (3)).

(*b*) It is exempt from the formalities as regards the filing of consent of the first directors to act (S. 181 (5) (*b*)).

(*c*) It is exempt from the restrictions on the commencement of business, and can exercise borrowing powers immediately on registration (S. 109 (7) (*a*)).

(*d*) It need not hold a "statutory meeting" nor prepare or circulate the "statutory report" (S. 130 (10)).

(*e*) It must have at least *one*, but need not have more than one, director, whereas "public" companies must have at least two directors (S. 176). (Note that a sole director cannot also act as secretary, even in a private company (S. 177).)

The following privilege, which all private companies enjoyed under the 1929 Act, has been taken away by the 1948 Act from all private companies, whether exempt or not: under the 1929 Act there was no compulsion (though there might of course be, and usually was, in the case of ordinary shareholders compulsion under the company's Articles) to circulate accounts to the members. The 1948 Act allows no such exemption, the obligation to forward accounts to *all* members (even those holding preference shares) applies to *all* companies (S. 158).

Finally among the privileges enjoyed by EXEMPT private companies only are these two:—

(*f*) They are exempt from filing a Balance Sheet (and annexed documents) with the Registrar (S. 129), but instead must file a certificate that the conditions of exemption have been complied with.

(*g*) It is not illegal (as it is in the case of other companies) for an exempt private company to lend money to its director(s) (S. 190 (1) (*a*)).

Exempt Private Company.—An exempt private company is defined by the Act as one which complies with the conditions set out in S. 129 (2) and the Seventh Schedule. S. 129 (2) lays down that the number of persons holding debentures in the company must not be more than fifty, no body corporate may be a director of the company, and there must be no arrangement whereby the policy of the company can be determined by persons other than the directors, members, or debenture holders. The conditions laid down in the Seventh Schedule (to which, however, there are certain exceptions which we will not go into here) are that:—

(1) no body corporate may hold any of the company's shares or debentures, and

(2) no person other than the holder may have any interest in any of the company's shares or debentures.

The general effect of these provisions is clear enough. They restrict the right not to file a Balance Sheet, etc., to companies which are not merely "private" in the technical sense used elsewhere in the Companies Act, but are also "private" in the everyday sense of the word. An example may perhaps make the point clearer. Suppose that up to (say) June 1949, X, Ltd., was an exempt private company, but in that month Y, Ltd. (with the consent of course of the directors of X, Ltd., without whose consent the transfer could not have been registered) acquired some shares (or debentures) in X, Ltd. The members of Y, Ltd., which we are assuming is a "public" company, have now an interest in X, Ltd., indirect it is true, but nevertheless real. Unless the interest of Y, Ltd., in X, Ltd., is large enough to give it control, X, Ltd., will not be a "subsidiary" of Y, Ltd. (see p. 527), and consolidated accounts will not be prepared. Consequently, the only way in which the acquisition of the shares in X, Ltd., would affect the statutory accounts of Y, Ltd., would normally be that the cost of acquisition would be included as an asset in the Balance Sheet of Y, Ltd. (either shown separately or possibly grouped with other similar assets), and the Profit and Loss Account of Y, Ltd., would show any dividends received from X, Ltd. Neither of these figures can be relied on as giving any clear indication of the trading results of X, Ltd., or its Balance Sheet position at any time, and unless the directors of Y, Ltd., like to disclose further information voluntarily they could keep their members completely in the dark as to how X, Ltd., was doing. The fact that Y, Ltd., has an interest in X, Ltd., however, means that X, Ltd., is no longer "exempt" and must file accounts, which means that though a member of Y, Ltd., does not have the accounts of X, Ltd., sent to him automatically as he does the accounts of Y, Ltd., nevertheless, he can inspect them on the file if he cares to do so.

It may be remarked that if, in the case we have just been considering, Y, Ltd., is itself an exempt private company and if the total number of shareholders in X, Ltd., and Y, Ltd., together is not more than fifty (excluding employees and counting joint holders as one), then X, Ltd., will itself continue to be an exempt private company. This is one of the exceptions referred to on p. 268.

Memorandum of Association.—This is a company's charter of incorporation. It sets forth the conditions on which the company exists and defines its objects. All acts exceeding the powers taken in the Memorandum are *ultra vires* the company, *i.e.* beyond its powers, and are consequently null and void.

The Memorandum of a company limited by shares must state:—

(*a*) The name of the company with " Limited " as the last word in its name.

(*b*) Whether the registered office of the company is to be situate in England or in Scotland.

(*c*) The objects of the company.

(*d*) That the liability of the members is limited.

(*e*) The amount of share capital with which the company proposes to be registered, and the division thereof into shares of a fixed amount.

No subscriber to the Memorandum, *i.e.* the seven or the two signatories, may take less than one share, and each subscriber must write opposite to his name the number of shares he takes (S. 2). The Memorandum must be stamped as a deed, and be signed by each subscriber in the presence of at least one witness who must attest the signature (S. 3).

Name of Company.—S. 17 provides that no company shall be registered by a name which in the opinion of the Board of Trade is undesirable. This provision differs from the corresponding provision (S. 17 also) of the Act of 1929. That section included various specific prohibitions, the most important from a practical point of view probably being that which prohibited the use of a name identical with that of a company already registered or so nearly resembling it as to be calculated to deceive. Among words which the Board would ordinarily prohibit are " Royal," " Imperial," " Municipal," or " Chartered." The words " Red Cross " cannot be used without the authority of the Army Council. Certain other words are also protected by various Acts.

Any company may, by passing and registering a special resolution with the written approval of the Board of Trade thereto, change its name (S. 18 [1]). If a company is registered (either originally or on a change of name) with a name which in the opinion of the Board of Trade too closely resembles the name of another company, the Board may, within six months of such registration, direct the company to change the name (S. 18 [2]). A new certificate of Incorporation is issued upon any change of name taking place.

A company must paint or affix its name in letters easily legible on the outside of every office or place where it carries on business; have its name engraven in legible characters on its seal; mention its name in legible characters in all notices and official publications of the company, and in all bills of exchange, promissory notes, endorsements, cheques, etc., and in all invoices and receipts (S. 108).

The abbreviation "Ld." or "Ltd." appears to be legal, but not in the Memorandum itself, where the word must be spelt in full. The word "Limited" may be dispensed with where it is proved to the satisfaction of the Board of Trade that the company is to be formed for promoting commerce, art, science, religion, charity, or any other useful object, and intends to apply its profits or other income in promoting its objects, and to prohibit the payment of any dividend to its members, and the Board of Trade has issued a permissive licence (S. 19).

Registered Office.—The Memorandum states the *part* of Great Britain (England or Scotland) where the registered office is situate. By S. 107, every company must, as from the day on which it begins to carry on business or as from the fourteenth day after the date of its incorporation, whichever is earlier, have a registered office to which all communications and notices may be addressed, and notice of the situation of the registered office or any change therein must be given within twenty-eight days after the date of incorporation or of any change to the Registrar of Companies who must record it. The registered office of a company is its official residence where writs may be properly served.

Objects of the Company.—The objects of a company must be legal, *i.e.* they must not be contrary to public policy or forbidden by Statute. A company cannot legally undertake any business other than that which by its objects clause it takes power to transact. S. 5 provides that the objects clause may be altered by special resolution for certain stated purposes, these purposes being to enable it: (*a*) to carry on its business more economically or efficiently; (*b*) to attain its main purpose by new or improved means; (*c*) to enlarge or change the local area of its operations; (*d*) to carry on some business that may conveniently or advantageously be combined with its existing business; (*e*) to restrict or abandon any of its objects; (*f*) to sell or dispose of the whole or any part of its undertaking; (*g*) to amalgamate with any other company or body of persons. In order to avoid unnecessary trouble or formalities later it is usual to make the objects clause as wide as possible, so as to cover all the business that a company is likely to undertake. It is anomalous that, on an alteration under S. 5, an amended copy of the Memorandum must be *printed* for filing, although the original may be hand-written or typed.

Share Capital.—The amount of capital which a company takes power in its Memorandum to issue is known as its nominal, registered, or authorised capital. If so authorised by its Articles originally, or as altered for the purpose by special resolution, a company may: (*a*) increase its capital; (*b*) consolidate and divide all or any of its share capital into shares of larger amount; (*c*) convert its paid-up shares into stock, and re-convert that stock into paid-up shares of any denomination; (d) subdivide its shares, or any of them, into shares of smaller amount; (e) cancel shares that have not been taken up or agreed to be taken up, and so diminish its capital by the amount of the cancelled shares (S. 61). The powers conferred by S. 61 must be exercised by the company in general meeting (S. 61 [2]). Usually a company takes power in its Articles to do all of these things.

If so authorised by its Articles originally, or as altered by special resolution for the purpose, a company may by special resolution after confirmation by the Court reduce its share capital *in any way*, and in particular by: (a) extinguishing or reducing the liability on any of its shares in respect of share capital not paid up; (b) with or without extinguishing or reducing liability on any of its shares, cancel paid-up share capital which is lost or unrepresented by available assets; (c) with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the company's wants (S. 66). A special resolution under S. 66 is called "a resolution for reducing share capital." But a cancellation of shares under S. 61 is not deemed to be such a resolution (S. 61 [3]).

Variation of Shareholders' Rights.—If the Memorandum or Articles contain provisions for varying the rights of any class of shareholders subject to the consent of any specified proportion of the holders of the issued shares of that class of the sanction of a resolution passed at a separate meeting of the holders of those shares, and at any time the rights are so varied, the holders of not less in the aggregate than 15% of the issued shares of that class, being persons who did not consent or vote in favour of the resolution for the variation, may apply to the Court to have the variation cancelled. The variation cannot then take effect until confirmed by the Court, which will examine the circumstances, and may disallow the variation if it thinks it would unfairly prejudice the shareholders of the class. A copy of the order of the Court must be filed within fifteen days (S. 72).

A company may by special resolution determine that any specified portion of its share capital not called up shall not be capable of being called up except in the event and for the purpose of the company being wound up (S. 60).

Redeemable Preference Shares and the issue of shares at a discount are dealt with on pp. 358 and 390.

Articles of Association.—These comprise the rules and by-laws which regulate the internal government of a company and its members. Both the Acts of 1929 and 1948 contain model sets of Articles, contained in the First Schedule in each case, and it should be noted that the two sets differ from each other in various respects. A company may adopt that table wholly; or adopt it to the extent that it satisfies its requirements, framing special articles to meet special needs; or draw up and register its own special set of articles. But no modified or special article may contravene the general law, or conflict with the provisions of the Companies Act. If no special Articles are filed, the Memorandum must be endorsed "Registered without Articles," and in that case every member of the company is bound by Table A. Of course a company's articles, *whatever they are,* are not altered by the passage of a new Act. Accordingly, a company which has adopted any or all of the clauses of Table A of the 1929 Act will continue after July 1948 to be bound by them as they stand, not by any of the clauses of Table A of the 1948 Act. On the other hand, a company which is registered or adopts fresh Articles after July 1, 1948, and in its articles refers to or adopts any clauses of Table A will be referring to or adopting clauses of the 1948 Act, not of the 1929 Act.

A private company *must* have articles, since its regulations must include restrictions and prohibitions which are not contained in Part I of Table A. A private company may, if it wishes, adopt Table A as modified by the six Articles contained in Part II; of these six articles two are in substitution for the corresponding Articles in Part I, while the other four are additional. Part II was first introduced by the Act of 1948; there was nothing corresponding in the 1929 Act.

It is worthy of note that, under S. 6, every unlimited and every guarantee company (with or without a share capital) must file articles.

The Articles and the Memorandum when registered bind the company in its dealings with members, and each member in dealing with the company or with fellow members, just as if each member had covenanted to be bound by them, but they do not bind the company or its members to non-members of the company.

Every person dealing with a company is deemed to have had notice of the contents of its Articles and Memorandum, since these are registered and available for perusal.

Provided that the acts of a company are within the powers of its Memorandum and Articles, a non-member is entitled to assume in his dealings with the company that the directors have been properly appointed and have acted regularly, unless he has had notice actual or constructive to the contrary.

The Articles may be read in order to explain any ambiguity in the Memorandum, or to supplement the Memorandum with regard to points on which that document is silent. Memorandum and Articles are within these limits construed together. Where they are inconsistent the Memorandum prevails.

Articles must: (*a*) be printed, (*b*) divided into consecutively numbered paragraphs, (*c*) stamped as a deed, (*d*) signed by each subscriber of the Memorandum in the presence of at least one witness who must attest the signature (S. 9).

Subject to the provisions of its Memorandum, a company may by special resolution alter or add to its articles, provided the alterations or additions do not contravene the provisions of the Act (S. 10), or the general law, or entail a breach of contract, and are made *bona fide*, and for the benefit of the company as a whole.

A private company must file Articles of Association comprised in which must be clauses: (*a*) restricting the right to transfer its shares, (*b*) limiting the number of members exclusive of employees and ex-employees to fifty, (*c*) prohibiting invitation to the public to subscribe for its shares or debentures. A private company may not issue share warrants, for such an issue would defeat the restriction upon the transfer of shares.

A company's Articles deal, *inter alia*, with such matters as: (1) Definition of terms. (2) Exclusions or modifications of Articles in Table A. (3) Regulations as to capital. (4) Payment of underwriting commission. (5) Borrowing powers. (6) Regulations as to the issue of shares; lien on shares; calls on shares; transfer and transmission of shares; forfeiture of shares; conversion of shares into stock; issue of share warrants; rights of the holders of different classes of shares; alterations of share capital. (7) General meetings and the proceedings thereat. (8) Voting powers of members. (9) The number, remuneration, qualification, and powers and duties of Directors. (10) Affixing the company's seal. (11) The disqualification, rotation, and proceedings of Directors. (12) The declaration and payment of dividends, and the provision of reserves. (13) The preparation of the company's accounts. (14) Issue of notices by the company. (15) Provisions regarding the retiring age of directors (if the company does not wish the rules laid down in S. 185 to apply, or desires to modify their application).

A company is bound to send to every member on his request a copy of its Memorandum and Articles at a charge not exceeding one shilling, and a copy of any Act of Parliament which alters the memorandum at a charge not exceeding the published price of that Act (S. 24).

Prospectus.—The issue of prospectuses is governed by SS. 37–46. The expression "Prospectus" is defined by S. 455 as meaning any prospectus, notice, circular, advertisement, or other invitation, offering to the public for subscription or purchase any shares or debentures of a company. The common form of these documents, though somewhat abbreviated, is amply illustrated in the public Press, and need not be set out here. Their object, of course, is to induce the public to take shares or debentures.

Very great responsibility attaches to all who authorise, or are responsible for, the issue of a prospectus. The inclusion of any untrue statement gives rise both to civil liability by way of action for damages by an aggrieved subscriber for shares or debentures (S. 43), and to criminal liability under S. 44. The civil liability is dealt with in more detail below, and is an extension of S. 37 of the 1929 Act. Criminal liability was not dealt with under the 1929 Act, but before 1948 criminal proceedings could, nevertheless, be taken under S. 84 of the Larceny Act, 1861.

Apart from the obligation not to include untrue statements, it is also an offence not to include any information which there is a statutory obligation to disclose. The nature of such information, most of which is detailed in the Fourth Schedule to the Act, is explained below. S. 39 of the 1948 Act, however (which is a new section not corresponding to anything in the 1929 Act), provides that, (*a*) where the prospectus is issued generally (that is to say to persons who are not existing members or debenture holders of the company) and (*b*) application is made to a prescribed stock exchange for permission to deal, that stock exchange *may* give a certificate exempting the company from compliance with the provisions of S. 38 and the Fourth Schedule. It does not seem likely that such exemption will often be given.

Under S. 43 an action may be brought for damages suffered by reason of any untrue statement in a prospectus against (*a*) every director (at the time of issue of the prospectus), (*b*) every person named as being a director or having agreed to become a director, (*c*) every promoter, and (*d*) every person who has "authorised" the issue of the prospectus. The last-mentioned category includes the "expert" (normally accountant or valuer) responsible for statements in the prospectus; before any such statement may appear in the prospectus the expert must give his written consent to its inclusion (S. 40), and the prospectus itself must include a statement that this consent has been given *and not withdrawn*. S. 43 goes on to lay down the circumstances that will avail each of the several categories of persons named as a valid defence against an action brought under the section. These are somewhat too complicated and detailed to set out in full here; typical provisions are: (1) (applying to any persons other than an expert) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue he forthwith gave reasonable public notice of this fact; (2) (applicable to an expert) that having given his consent under S. 40 he withdrew it in writing before delivery of a copy of the prospectus for registration, or that after registration but before allotment he withdrew his consent and gave reasonable public notice of such withdrawal, or that he was competent to make the statement and that he had reasonable ground to believe and did up to the time of the allotment (of the shares or debentures) believe that the statement was true. It should be noted that in each case the onus of proving these facts is on the defendant: *prima facie* the mere proof of the untruth of the statement complained of renders the director or expert, etc. (as the case may be), liable.

The measure of damages is usually the difference between the true value of the shares at the time of allotment and the price paid for them; and this, at the highest, may be the full nominal value of the shares.

Usually, the rights of rescission, and of action for damages at common law, or for compensation under S. 43, are capable of exercise by original allottees only.

It should hardly be necessary to remind the professional student that if the prospectus contains an accountant's report, the report should be based upon the facts and not upon estimates.

Statutory Requirements.—The following statutory requirements must be fulfilled:—

(*a*) Every prospectus must bear a date, and unless the contrary be proved, that date is taken to be the date of publication (S. 37).

(*b*) A copy must be signed by every person named therein as a director or proposed director and filed with the registrar on or before the date of its publication, and a statement that a copy has been duly filed must appear on the face of the prospectus. The filed copy must have, either endorsed on it, or attached to it, the original of any consent by an expert required by S. 40, and copies of every contract required by para. 14 of the Fourth Schedule to be stated on the prospectus (see below) (S. 41 [1]).

(*c*) Every prospectus must specify the following matters, as detailed in Part I of the Fourth Schedule (the paragraphs are numbered in accordance with the Schedule):—

(1) The number of founders' or management or deferred shares (if any) and the nature and extent of the interest of the holders.

(2) The number of shares (if any) fixed by the articles as the qualification of a director, and any provision in the Articles as to the remuneration of the directors.

(3) The names, description, and addresses of the directors or proposed directors.

(4) Particulars as to "minimum subscription," and if any money is to be provided otherwise than out of the proceeds of the issue for the purchase of property, preliminary expenses, or working capital, etc., the source from which such money is to be provided.

(5) The time of opening of the subscription lists.

(6) The amount payable on application and allotment on each share and, in the case of a second or subsequent offer of shares, the amount offered for subscription on each previous allotment made within the two preceding years, and the amounts actually allotted and paid on such shares.

(7) Statutory particulars regarding shares or debentures under option.

(8) Particulars regarding any shares or debentures issued or agreed to be issued, during the two preceding years, for a consideration other than cash.

(9) As regards any property purchased or proposed to be purchased wholly or partly out of the proceeds of the issue, or the purchase of which has not been completed at the date of issue of the prospectus (other than property acquired in the ordinary course of business): (*a*) the names and addresses of the vendors, (*b*) the amount payable to the vendor in cash, shares, or debentures, and (*c*) short particulars of any transaction relating to the property completed within the two preceding years in which any director or promoter of the company had any interest.

(10) The amount, if any, paid or payable as purchase money in cash, shares, or debentures for any property mentioned in (9), specifying the amount, if any, payable for goodwill.

(11) The amount, if any, paid or payable during the two preceding years for under-writing commission on any shares or debentures of the company.

(12) The estimated amount of preliminary expenses and the persons to whom any such expenses are paid or payable, also the amount of the estimated expenses of the present issue and the person(s) by whom such expenses are paid or payable.

(13) Any amount paid or payable within the preceding two years to any promoter, and the consideration for such payment.

(14) The dates of, parties to, and general nature of every material contract (other than a contract entered into in the ordinary course of business) entered into within the two preceding years.

(15) The names and addresses of the auditors, if any, of the company.

(16) Full particulars of the nature and extent of the interest of every director in the promotion of, or the property proposed to be acquired by, the company.

(17) If the prospectus invited subscription for shares and the capital of the company is divided into different classes of shares, the voting, capital, and dividend rights of each class of shares.

(18) If the business of the company, or the business to be acquired, has been carried on for less than three years, the length of time during which such business has been carried on.

(*d*) Part II of the Fourth Schedule specifies the following reports to be set out:—

(19) (*a*) A report by the company's auditors on the profits and losses, assets, and liabilities, as follows:—

If the company has no subsidiaries, the profits and losses of the company for each of the five financial years immediately preceding the issue of the prospectus, and the assets and liabilities at the last date to which the company's accounts were made up.

If the company has subsidiaries, *either* particulars as to profits and losses as above and also similar particulars regarding the subsidiaries (so far as they concern the company, *i.e.* excluding minority interests) either individually for each subsidiary or in total, *or* consolidated profit and loss figures for the group; and, as regards assets and liabilities, particulars regarding the company's own assets and liabilities as above and *either* the consolidated assets and liabilities of the group *or* the individual assets and liabilities of each subsidiary.

(20) If the proceeds, or part of the proceeds, of the issue is to be applied to purchase any business, a report by accountants (who must be named in the prospectus) on: (*a*) the profits and losses of the business for each of the five years preceding the issue of the prospectus, and (*b*) the assets and liabilities of the business at the last date to which the accounts of the business have been made up.

(21) If the proceeds, or part of the proceeds, is to be applied in the purchase of shares in another company, particulars as in (20) regarding the profits and losses, assets, and liabilities of that company, and in addition the report must show how the profits or losses of that company (including its subsidiaries if any) would have concerned members of the company issuing the prospectus and what allowance in relation to assets and liabilities would have had to be made for holders of other shares (*i.e.* shares not acquired) if the company issuing the prospectus had held the shares in question during the period dealt with.

(c) Part III of the Fourth Schedule contains certain definitions and provisions modifying the provisions of Parts I and II in particular cases, *e.g.*

(22) Paragraphs 2, 3, 12 (so far as it relates to preliminary expenses), and 16 are not to apply to a prospectus issued more than two years after the company is entitled to commence business.

(27) If the company, or the business to be acquired, has been carrying on business for less than five years, the number of years to be covered by the reports under (19) and (20) are reduced accordingly.

(28) If there has, during the period of five (or less) years to be covered by the reports under (19) or (20) been an alteration in the accounting date, any greater or less period than a year between two consecutive accounting dates shall be treated as a " financial year."

(29) The statutory reports are *either* to indicate by way of note any adjustments considered necessary by the person making the report *or* to make the adjustments and indicate that they have been made.

(30) This paragraph lays down rules as to the qualification of an accountant called on to make the reports called for by Part II.

It should be noted that if application is being sought for the shares or debentures to be quoted or dealt in on a stock exchange, the prospectus must give particulars complying not only with the rules laid down by the Act as above, but also with any conditions which may be laid down by the council of the stock exchange concerned. These conditions may, in some respects, be more stringent than those laid down by the Act. As an instance of this, the London Stock Exchange requires that the reports of past profits shall deal with the figures of the past ten years, as against the five years called for by the Act.

Statement in Lieu of Prospectus.—Public companies which do not issue a prospectus must, under S. 48, file with the registrar a *Statement in Lieu of Prospectus* in the form and containing the particulars set out in the Fifth Schedule of the Act of 1948. Briefly stated, the requirements of this document are similar to those required for the prospectus itself, viz. nominal share capital and the classes of shares into which it is subdivided; names, descriptions, and addresses of the directors; voting, capital, and dividend rights of the several classes of shares; number and amount of shares and debentures issued as fully or partly paid otherwise than in cash, and the consideration therefor; names and addresses of vendors, and the amount in cash, shares, or debentures payable to each, specifying, separately, the amount (if any) payable for goodwill; amount payable for underwriting or other commission for subscribing or procuring subscriptions for shares or debentures of the company or the rate of the commission; number of shares, if any, which persons have agreed for a commission to subscribe absolutely; estimated amount of preliminary expenses, amount paid or intended to be paid to any promoter, and the consideration therefor;

dates of and parties to every material contract, and time and place when and where the contracts or copies of them can be inspected; names and addresses of the auditors (if any); particulars of the nature and extent of the interest of every director in the promotion of, or in the property to be acquired by, the company; if it is proposed to acquire any business, the amount, as certified by the auditors of that business, of the net profits for each of the last five financial years, or such less period as the business has been carried on.

A somewhat similar "Statement in Lieu of Prospectus" must, under S. 30, be filed by a company which has hitherto been a private company but has now ceased to be one. Since a private company must include in its Articles certain clauses which are inconsistent with its being a public company, it can become a public company *legally* only by altering those Articles, and S. 30 provides that as soon as a company so alters its Articles it shall forthwith cease to be a private company and must within a period of fourteen days thereafter deliver to the registrar the Statement in Lieu of Prospectus in the form set out in the Third Schedule.

Promoter.—The person who does the preliminary work in the flotation of a company and sets it going is called the "promoter." The term "Promoter" is a term not of law but of business, summing up in a single word a number of business operations, familiar to the commercial world, by which a company is brought into existence. He secures, *e.g.* a contract to acquire the business or property which the company is to take over, attends to the preparation of Memorandum and Articles; to finance; and to registration of the company.

A promoter stands in a fiduciary position towards the company, and may not make any *secret* profit for himself out of the promotion, or otherwise benefit himself at the expense of the company. He must disclose to the company every material fact that the company has a right to know. Action will lie against a promoter who has made a secret profit, the measure of damages being the amount of that profit less reasonable expenses incurred in connection therewith.

Preliminary Contracts.—These are agreements entered into prior to the formation of a company between vendors of property to be acquired by the company and the company itself, or with an agent acting for the company. The company is not bound by such agreements until the directors have adopted them by entering into a new contract based upon new consideration after the company has been incorporated. And until that has been done the company cannot sue the vendors. An agent acting for the company is personally bound by such agreements, and, usually, he protects himself by taking power in the agreement to rescind them should the company not be incorporated, or not proceed to allotment within a reasonable time.

Preliminary Expenses.—These comprise, *inter alia*, the cost of preparing and printing the Memorandum, the Articles, and the Prospectus, and of circulating and advertising the Prospectus; the cost of registering the company and the statutory documents, together with fees and stamp duties payable thereon; the cost of drawing up the preliminary contracts and stamp duties thereon; cost of printing and stamping debentures (if any) and of share certificates and letters of allotment; cost of the seal and original books of the company; and (separately stated) the amount paid or payable to any promoter, and for underwriting commission; law costs in connection with all or any of these matters. Preliminary expenses are not allowed as a charge against profits for income-tax purposes, except expenditure incurred in purchasing books of account, stationery, the company's seal, and the like.

The promoter usually undertakes liability for these expenses in the first place, and looks to the company to relieve him of it, after incorporation. But vendors acting also as promoters not infrequently undertake to defray these expenses out of the purchase consideration received by them from the company. In order to make his own position secure a promoter must take care that he is in a position to compel the company as soon as it is incorporated to enter into a binding agreement to discharge these expenses. An agreement made prior to incorporation by a company cannot be ratified. A new agreement based upon new consideration * must be entered into by the company after incorporation. Where a company does not proceed to allotment, the promoter is personally liable for the preliminary expenses, except in so far as he has contracted out of this liability, *e.g.* with printers, etc.

Vendor.—Part III, Fourth Schedule (23) defines a vendor as every person who has entered into any contract, absolute or conditional, for the sale or purchase, or for any option of purchase, of any property to be acquired by the company, in any case where:—

(*a*) the purchase money is not fully paid at the date of the issue of the prospectus;

(*b*) the purchase money is to be paid or satisfied wholly or in part out of the proceeds of the issue offered for subscription by the prospectus;

(*c*) the contract depends for its validity or fulfilment on the result of that issue.

Where a company is to take property on lease, the lessor is a vendor, and the purchase money is the consideration for the lease.

It is not necessary to state in the prospectus the names and addresses of every vendor or sub-vendor, and the amount, whether it be in cash, shares, or debentures, which each is to receive, provided the property acquired is paid for in cash prior to the issue of the prospectus, but even then there is a duty to disclose such contracts in the prospectus, if they are material contracts; to state the dates and the parties to them, and a reasonable time and place at which they (or copies) may be inspected.

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* It is usual to bring in this new consideration by including preliminary expenses with property being transferred, or by the promoter making payment of the preliminary expenses part of a contract for continuing services with the company. But it is usual for the company's objects to include the payment of the preliminary expenses, and the need for the new agreement does not then arise.

Directors.—The persons appointed to manage the affairs of a company on behalf of the general body of shareholders are called the *Directors* or, collectively, *The Board of Directors*, or, shortly, *The Board*. Every public company registered after October 31, 1929, must have at least two directors (S. 176), and every company registered on or before that date, and every private company must have a director. Up to July 1, 1948, it was possible for a private company to have no director at all, and the author actually knew of a company where this was the case.

Directors may be appointed by (*a*) the signatories to the Memorandum, (*b*) the Articles, (*c*) the directors themselves, in the case of a vacancy, (*d*) the members in general meeting, (*e*) a third party empowered by the Articles to appoint. Frequently, the Articles state that the first directors of the company shall be appointed by the signatories to the Memorandum. If that be so, a formal letter is signed by all the signatories, or by a majority, if power is so given by the Articles, appointing certain persons as directors. This document should be pasted in the Minute Book.

The directors' powers and duties are defined, and their remuneration is fixed, by the Articles. Every director must qualify himself within two months of appointment by acquiring the number of shares fixed by the Articles as to the qualification of a director (S. 182). The Articles of most companies fix the minimum number of shares which each director must hold. However, subject to the Articles, a director need not be a member of the company. Clause 66 of Table A under the 1929 Act provided that a director should hold at least one share, but clause 77 of the new Table A under the 1948 Act is different: it runs "The shareholding qualification for directors may be fixed by the company in general meeting, and unless and until so fixed no qualification shall be required." A person cannot be appointed a director by the Articles, and must not be named as a director or proposed director in a prospectus issued by or on behalf of the company or in a statement in lieu of prospectus filed by or on behalf of the company unless he has by himself or his agent authorised in writing, signed and filed a written consent to act and either:—

(i) signed the memorandum for a number of shares not less than his qualification, if any; or

(ii) taken from the company and paid or agreed to pay for his qualification shares, if any; or

(iii) signed and filed a contract to take from the company and pay for his qualification shares, if any; or

(iv) made and filed a statutory declaration to the effect that the requisite shares are registered in his name (S. 181).

A director who is required to hold qualification shares must obtain them within two months of the date of his appointment (or such shorter time, if any, as may be fixed by the Articles). If he does not obtain them within the time allowed, or if having obtained them he subsequently ceases to hold them, he ceases to be a director (S. 182).

Besides the ordinary supervision of the commercial activities of the company, the directors' duties include: the issue of capital; allotment of shares; making of calls; forfeiture of shares; passing of transfers; issue of certificates; issue of debentures; calling of meetings; ensuring that proper accounts are kept; recommendation of dividends, etc.

Directors are special agents of the company, but they do not incur personal liability on any contracts they may enter into if they act within their authority and the powers of the company. It would appear from the decision in *Lagunas Nitrate Co.* v. *Lagunas Nitrate Syndicate*, 1899, that directors incur no personal liability for mistakes and errors of judgment, if they act within their powers, and honestly, and with reasonable care, unless the mistake was "in a business sense culpable or gross." Every director must disclose to the Board the nature of his interest in any contract or proposed contract. This can be done by giving a general notice that he is a member of a specified company or firm (S. 199).

It is illegal for any payment to be made to a director by way of compensation for loss of office without the proposed payment being first disclosed to the members and approved by them (SS. 191 and 192). Under the 1929 Act (S. 150) this prohibition related only to loss of office in connection with the transfer of the whole or part of the undertaking, when the compensation would normally be paid by the company taking over the undertaking. This provision of the 1929 Act is re-enacted by S. 192 of the 1948 Act, while S. 191 of the 1948 Act, which extends the prohibition to compensation under all circumstances, is new: the result of the extension is to include cases where the compensation is payable by the company in question itself. The office of director can be assigned only when approved by special resolution (S. 204). The Articles usually provide that a proportion of the directors shall retire annually, and either be re-elected, or their places be filled by other directors appointed by the members in general meeting, the Board having power to fill casual vacancies. An undischarged bankrupt can act as director only with the leave of the court (S. 187).

Every company registered after November 22, 1916, every foreign company establishing a place of business in Great Britain, and every company registered under the Moneylenders Act, 1927, must disclose on its notepaper, and in trade catalogues, circulars, etc., the name of every director, and his nationality if he is not British, and his former nationality if his nationality is not the nationality of origin.

Since July 1, 1948, it has been illegal for a company to pay its directors any remuneration "free of income tax" (S. 189). The prohibition over-rules any provision there may be in the company's articles (of whatever date), and any contract or article (other than as mentioned below) which provides for a stated amount of remuneration to be paid "free of tax" must be construed as providing for the payment of the same amount "gross," that is subject to tax. This exception relates to any contract (but *not* a provision in the company's articles") which was in force on July 18, 1945, and which makes express provision for remuneration to be paid free of tax.

Before July 1, 1948, a provision of this nature in the company's articles was valid.

Managing Director.—The majority of companies take power in their Articles to appoint one (or more) of their number as Managing Director(s) and to fix his or their remuneration. In such cases some of the duties of the Board are frequently delegated to the Managing Director(s). It is also usual to provide that, while such managing directors continue in office, they shall not need to come up for re-election in order of rotation as do the other directors.

Age Limit of Directors.—The Act of 1948 introduced a number of provisions having no counterpart in the Act of 1929. The more important of these provisions, which apply to all public companies, and to private companies which are themselves subsidiaries of public companies, are as follows:—

(1) Except as provided, no one can be appointed a director after reaching the age of seventy years.

(2) Except as provided, a director must retire at the next annual general meeting after he reaches the age of seventy.

(3) The last-mentioned provision is not to apply to a director who was in office on July 1, 1948, until the third annual general meeting after that date.

(4) The first two provisions are not to apply if the appointment is made by the company in general meeting after special notice has been given stating the age of the director in question.

(5) If a company's existing articles already contain provision for the retirement of directors under an age limit, the provisions in S. 185 are not to apply to directors subject to the provisions of the articles. Further, any company may alter its articles (after the commencement of the Act) so as to prevent the application of the Act.

S. 186 contains provisions compelling any director who is over the age limit to disclose his age and specifying a penalty (up to £5 a day) for non-compliance.

Common Seal and Contracts.—The common seal with the company's name engraved thereon in legible characters, which, by S. 108, a company is bound to keep, is the company's official signature. It is impressed upon all share and debenture certificates, and upon all contracts, which, if entered into between private persons, would have to be in writing and executed under seal. The Articles usually provide that the seal shall be affixed in the presence of two directors and the secretary of the company, and that after affixation the document shall be signed by them. It is usual to keep a register of sealed documents. The use of the seal is safeguarded by its being kept under lock and key.

Contracts which if made between private persons must by law be in writing and signed but need not be under seal, must in the case of companies be in writing, and signed by someone acting under its express or implied authority. Contracts which between private persons may be made by parol (orally) may in the case of companies be made by parol by any authorised person (S. 32).

Official Seal for Use Abroad.—A company whose objects require or comprise the transaction of business in foreign countries may, if authorised by its articles, have for use in any territory, district, or place not situate in the United Kingdom, an official seal, which must be a facsimile of the common seal, with the addition on its face of every territory, district, or place where it is to be used. By writing under its common seal, the company can authorise any person appointed for the purpose to affix the official seal to any deed or other document to which the company is party in that territory, district, or place. The authority of such agent as between the company and any persons dealing with the agent continues during the period mentioned in the instrument conferring the authority, or if no period is mentioned, until notice of the revocation has been given to the person dealing with him. The agent must, by writing under his hand, certify on the deed or other document, the date and place of affixing the official seal. Any deed or other document so sealed and certified binds the company as if sealed with the common seal (S. 35).

Underwriting.—In these days, few public companies are formed without the whole or part of the capital issue having been previously underwritten. This term means that certain persons termed *Underwriters* have entered into a contract with the company to subscribe for any shares or debentures which are not taken up by the public, in consideration for which the company undertakes to pay to them a commission termed *Underwriting Commission*. Underwriting commissions vary from 1% to 10%, according to the risk attaching to the issue, and may be paid in cash or by way of fully paid shares. Payment of underwriting commission is, practically, an insurance to secure the success of a capital issue.

It is a common practice to sell the whole issue of shares or debentures to a financial house, termed an *Issuing House*, which, in turn, offers the shares or debentures to the public. The Issuing House can then make an "offer for sale." In this event a document by which the offer for sale is made is to be considered as a prospectus, and all the rules regarding the issue of a prospectus by the company apply (S. 45). It is *prima facie* evidence that the allotment to the issuing house was made with a view to the shares or debentures being offered to the public if it is shown that an offer to the public actually was made within six months after the date of allotment, or that at the date of the offer the whole of the consideration money had not been received by the company (S. 45 (2)).

The payment of underwriting commission is *ultra vires* unless it is authorised by the Articles and disclosed in the Prospectus or Statement in Lieu, and the rate paid does not exceed the rate authorised by the articles (which must not exceed 10%) (S. 53). The amount so paid must be separately stated in the Balance Sheet, or so much thereof as has not been written off, until the whole has been written off (Eighth Schedule, Part I, para. 3).

Illustration.—A. B. undertakes to underwrite the whole of an issue of 10,000 ordinary shares to be issued by Blanks, Ltd. The public subscribe for 5,000 shares only. Under his agreement, therefore, A. B. must take up the balance of 5,000 shares.

An underwriter is only responsible *pro rata.* Thus if the share issue of Blanks, Ltd., was £50,000, and A. B. agreed to underwrite half the issue, and the public subscribed for £40,000, then A. B. would be relieved to the extent of £20,000, and would have to subscribe for £5,000 only, unless his agreement provided otherwise.

Underwriters frequently place a portion of the risk assumed by them with others, termed *Sub-Underwriters,* with whom they share their commission. In such cases the underwriters are usually paid an additional *Overriding Commission* of small amount.

The cost of the underwriting may be borne by the promoter. If so, it does not concern the company. But if the company bears the cost, a separate account must be opened for underwriting commission. Since the Eighth Schedule requires the balance of this account, so far as it is not written off, to be separately disclosed in the Balance Sheet, it cannot be carried to a Preliminary Expenses Account.

Illustration.—Blanks, Ltd., enter in an agreement with the X. Y. Promoting Syndicate, Ltd., to underwrite an issue of 50,000 of their ordinary shares of £1 each for an underwriting commission of 4% and an overriding commission of 1%. The Syndicate underwrites £20,000 of the issue, and places the balance of £30,000 on sub-underwriting terms with A, B, C, and D. The commission payable will be as follows:—

	£	s.	d.
X. Y. Promoting Syndicate.			
4% Underwriting Commission, and 1% Overriding Commission on £20,000 (*i.e.* 5% in all)	1,000	0	0
1% Overriding Commission on £30,000, sub-underwritten with A, B, C, and D	300	0	0
	1,300	0	0
A, B, C, and D.			
4% on £30,000 sub-underwritten	1,200	0	0
Total commission payable	£2,500	0	0

The subject of underwriting and sub-underwriting has become somewhat complicated, and the student who wishes to pursue the subject further is referred to the author's *Accounting,* pp. 124–126.

Brokerage.—Brokerage is distinct from underwriting commission, but examination candidates often confuse the two. Underwriting commission may be paid only under the conditions named above, but brokerage may be paid by any company. The offer to pay brokerage appears in most prospectuses. Its payment is recognised by S. 53 [3], and is within the power of limited companies (*Metropolitan Coal Consumers' Association* v. *Scrimgeour,* [1895]). It consists of a small sum, *e.g.* 3*d.* per share, paid to stockbrokers and others for placing shares with their clients. The brokers send copies of the prospectus, with their rubber stamp on the application form, to their clients. If shares are allotted to the applicants on these forms, the brokers must be credited with the brokerage due to them, and Preliminary Expenses Account be debited with a like amount. The brokerage is not required, like underwriting commission, to be separately stated in the Balance Sheet.

The rate of brokerage paid must be "reasonable," *e.g.* in the *Metropolitan, etc.*, case (*supra*) $2\frac{1}{2}\%$ was held to be reasonable.

Auditors.—The auditors of a company are officers of the company in so far as audit of the company's accounts is concerned (*London and General Bank*, [1895]; *Kingston Cotton Mill Co., Ltd.*, [1896]). They are also agents for the shareholders.

Every company must at each annual general meeting appoint an auditor or auditors to hold office until the next annual general meeting. If no resolution is passed the retiring auditor is reappointed automatically (S. 159 (2)). (This is a new provision introduced for the first time by the 1948 Act). The remuneration of the auditors is either fixed by the company in general meeting or "in such manner as the company in general meeting may determine" (S. 159 (7)); the last expression covers the quite common case where the members authorise the directors to settle the fee with the auditors. Unless, however, the members fix the fee themselves the amount must be disclosed in the Profit and Loss Account (Eighth Schedule, Part I, para. 13). If no auditor is appointed, the Board of Trade, on the application of any member, may appoint an auditor and fix his remuneration (S. 159 (3)). The following persons cannot act as auditor:—

(*a*) a director or officer of the company;
(*b*) except where the company is a private company, a partner or employee of an officer of the company;
(*c*) a body corporate (S. 133).

But the first auditors of the company may be appointed before the first annual general meeting by the directors, who may fix their remuneration. These hold office until the first annual general meeting, unless they are previously removed by resolution of the shareholders in general meeting. If they are so removed the shareholders at that meeting may appoint others in their place. The directors may fill any casual vacancy in the office of auditor, but while there is a vacancy the continuing auditors (if any) may act (S. 159 (6)).

If it is desired to nominate for appointment as auditor at an annual general meeting any person other than a retiring auditor or providing expressly that the retiring auditor shall not be reappointed (*i.e.* without naming a successor) "special notice" is required (S. 160 (1)); the special notice must be given to the company not less than twenty-eight days before the meeting (S. 142), and the company must give to the members the same notice of the resolution as it gives of the meeting itself (twenty-one days). Notice must also be given to the retiring auditor, who may reply by making representations in writing to the company (of reasonable length) and requesting their notification to the members. If, either because the representations are not received in time or because of the company's default, the auditor's representations are not sent to the members he may require them to be read out at the meeting.

The auditor has at all reasonable times right of access to the books, accounts, and vouchers of the company, and he may require directors and other officers of the company to furnish him with such information and explanations as he may require (S. 162 [2]). No article which attempts to limit or interfere with the rights of an auditor is valid (*Newton* v. *Birmingham Small Arms Co., Ltd.*, [1906]).

The auditor must make a report to the shareholders on the accounts examined by him and on every Balance Sheet laid before the company in general meeting. A copy of this report must be attached to every such Balance Sheet. The report must be read at the annual general meeting. In it the auditor must state: (1) whether he has obtained all the information and explanations which to the best of his belief were necessary for the purposes of his audit; (2) whether, in his opinion proper books of account have been kept by the company, so far as appears from his examination of those books, and proper returns adequate for the purposes of his audit have been received from branches not visited by him; (3) whether the company's Balance Sheet and Profit and Loss Account dealt with by the report are in agreement with the books of account and returns; and (4) whether, in his opinion and to the best of his information and according to the explanations given him, the said accounts give the information required by the Act in the manner so required and give a fair view (*a*) in the case of the Balance Sheet, of the state of the company's affairs at the end of its financial year, and (*b*) in the case of the Profit and Loss Account, of the profit or loss for its financial year (S. 162 [1] and Ninth Schedule). In the case of a holding company which submits group accounts, the auditor's report must also cover the group accounts in a somewhat similar manner, but we need not here go into the detailed requirements of the Ninth Schedule in that connection.

The auditors are entitled to attend any general meeting of the company and to receive all notices of any general meeting which any member of the company is entitled to receive and to be heard at any general meeting which they attend on any part of the business of the meeting which concerns them as auditors (S. 162 [4]).

Every company must, not less than twenty-one days before a meeting at which the accounts are to be laid before the members, send a copy of the accounts, including the auditors' report, to every member (whether or not he is entitled to receive notices of meetings) and every debenture holder (S. 158). This now applies even to private companies, which was not the case under the 1929 Act: further, the 1948 Act extended the time during which the accounts must be in the members' hands, which was previously seven days.

A typical auditors' report under the 1948 Act, where the company is not a holding company and there are no matters regarding which the auditors wish to comment adversely, might run as follows:—

REPORT OF THE AUDITORS TO THE MEMBERS OF BLANKS, LTD.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. In our opinion proper books of account have been kept by the company so far as appears from our examination of those books. We have examined the above Balance Sheet and the annexed Profit and Loss Account, which are in agreement with the books of account. In our opinion and to the best of our information and according to the explanations given to us, the said accounts give the information required by the Companies Act, 1948, in the manner so required, and the Balance Sheet gives a true and fair view of the state of the company's affairs as at December 31, 1949, and the Profit and Loss Account gives a true and fair view of the profit for the year ended on that date.

Auditors are not responsible for the method of presenting a company's accounts; neither can they dictate the form those accounts shall take. But they can decline to certify accounts which, in the form presented, are in their opinion misleading. The accounts are the accounts of the Directors, and only for grave reasons have the auditors power to interfere with the form of their presentation. The auditors must report wherein the accounts do not conform with the Act, and, in particular, with S. 197 (see p. 491).

The duties of auditors cannot be dealt with at length in this place. Brief extracts from the *dicta* of British judges may, however, be usefully quoted:—

> "His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that." (*London and General Bank, Ltd.,* [1895].)
>
> "Auditors of a limited company are bound to know, or make themselves acquainted with, their duties under the articles of the company whose accounts they are appointed to audit and under the Companies Acts." (*Republic of Bolivia Exploration Syndicate, Ltd.*)
>
> "That it is the duty of a company's auditor in general to satisfy himself that the securities of the company in fact exist and are in safe custody cannot, I think, be gainsaid. . . . The duty of the auditor is to verify the facts which it is proposed to state in the balance sheet, and in doing so to use reasonable and ordinary skill." (*City Equitable Fire Insurance Co., Ltd.*)
>
> "It is no part of an auditor's duty to take stock. . . . He must rely on other people for details of the stock-in-trade on hand." (*Kingston Cotton Mill Co., Ltd.,* [1896].)
>
> "It is the duty of an auditor to bring to bear upon (his) work . . . that skill, care, and caution which a reasonably competent, careful, and cautious auditor would use. What is reasonable . . . depends upon the circumstances of each case. . . . Auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud, *when there is nothing to arouse their suspicion*, and when those frauds are perpetrated by tried servants of the company and are undetected for years by the directors." (*Kingston Cotton Mill Co., Ltd.,* [1896].)
>
> "An auditor . . . is bound to make a reasonable and proper investigation of the accounts and of the stock sheets so far as he can, and if a reasonable and prudent man would have come to the conclusion that there was something wrong, then it is his duty to call the attention of his employers to it, and in that consideration he is entitled to take into account the fact that the documents are vouched for by trusted servants of his employers. . . . They are entitled to rely on the certificate of the managers. . . . It was their duty to a certain extent to examine the accuracy of the certificate." "Although it is quite clear that it is not the duty of an auditor to take stock, one cannot say that it may not be his duty to call attention to suspicious items appearing in the stock sheets. (*Mead* v. *Ball, Baker & Co.*)

The Secretary.—The office of secretary is made statutory for the first time by the Act of 1948. Every company must now have a secretary (even a private company) (S. 177). Generally speaking, the duties of the secretary will be such as the directors may delegate to him, but he must in any event sign the annual return (together with a director) and certify that the accompanying Balance Sheet with annexed documents (including the auditor's report) are true copies. The normal (non-statutory) duties of a secretary are described below. There is nothing to prevent a director acting also as secretary provided that he is not a sole director (S. 177 [1]): in that event the secretary must be a different person.

The secretary is an agent of the company for the particular duties he is deputed to perform, and the executive officer of the Directors, to whom he is responsible. It is his duty to ensure that the Directors' instructions are passed on to, and carried out by, the staff. He must see that the company fulfils all legal requirements, and that the provisions of the Memorandum and Articles are complied with. In particular, it is his duty to conduct the general correspondence of the company; to prepare the agenda for directors' and general meetings, and to record accurate minutes of the proceedings at these meetings; to see that the statistical books are properly kept; to satisfy himself that transfers are in order before bringing them before the directors to be passed; and (usually) to sign or countersign all cheques, share certificates, dividend warrants, and similar documents, after having previously verified them before sealing and or signature by the directors.

Subscription List.—The prospectus inviting public subscription to the company's capital issues having been circulated, the next step is to prepare the *Subscription List.* This usually takes the form of separate *Application and Allotment Sheets* for the different classes of shares, suitably ruled to record the necessary particulars. The prospectus usually includes a printed *Application Form.* This is filled in by the applicant, and sent, together with the amount payable per share on application, to the company's bankers. A specimen Application and Allotment Sheet, and an Application Form, are shown on pp. 292–293.

The prospectus must state the period during which the subscription list will remain open. There is no statutory limit as to duration. It was at one time the usual practice to leave the list open for several days, very often three: it is common now, especially where the issue is expected to be a popular one and over-subscribed, for the list to be open for five minutes only, usually from "10.0 to 10.5 a.m." When the list has been closed, the application forms are handed over by the bankers to the company. These should be numbered and checked with the Bank Pass Book, from which, in due course, the Shareholders' Cash Book is written up. In many cases it is more expeditious to add a column to the Application Book (or sheets) for use as a Shareholders' Cash Book. The Allotment Sheets are prepared from these materials for the consideration of the Directors, who allot the shares at their discretion. This proceeding is known as *going to allotment.* Frequently preference is given to those applicants likely to prove most useful to the company as customers or otherwise. Where an issue is over-subscribed the shares applied for cannot all be allotted, and a formula has to be devised for determining which applications to accept (in whole or in part) and which to reject. The devising of such a formula is entirely a question of policy for the directors to determine, in conjunction, should they so wish, with any proposal by the "issuing house," should one be employed. Common variations are: (1) the complete rejection of all applications for small amounts (say for less than 500 shares); (2) the partial acceptance of all applications in part, according to a formula, *e.g.* all applicants for between 100 and 500 shares to be allotted 100, applicants for between 500 and 1000 shares to be allotted 200, and so on (possible variations are legion); (3) (often used where the over-subscription is very heavy indeed) a reduction of the list by one of the above methods coupled with a ballot, applicants who are unlucky in the ballot getting nothing; (4) acceptance in full of all small applications, up to a determined limit, coupled with a greater or less "scaling down" of larger applications. The last method is most popular with shares of retail-trading concerns, where it is thought that having a large number of small shareholders, rather than a less number of larger ones, tends to increase the number of customers who do business with the concern. Another point, often taken into consideration where over-subscription is heavy, is the desirability of allotting shares to genuine investors who wish to hold them, while rejecting applications from "stags," who merely intend to sell out at a profit as soon as they can: this, however, is a difficult problem, probably incapable of complete solution.

When a portion of the capital of a company remains unissued, the directors have power, either under the Articles, or after a special resolution has been passed, to issue the balance of shares whenever it may seem expedient to do so in the interests of the company. But they must recognise their fiduciary position as directors, and act *bona fide* in the interests of the company as a whole. They may not, for example, issue the shares in order that they themselves or their friends may take them up and obtain control of the undertaking (*Cook* v. *Barry, Henry, & Cook, Ltd.*, [1923]) or prevent another person from becoming a director.

The act of allotment, which is duly recorded in the Minutes, signifies the acceptance by the Directors of the offers of the applicants to take shares, and the contract is complete as soon as the allotment letter is posted.

No allotment can take place unless the minimum subscription (if any) has been secured, and the application moneys, which must not be less than 5% of the nominal value of the shares, have been received by the company.

Letter of Regret.—When no allotment of shares is made to an applicant, a letter of regret, together with a cheque returning the application money, is sent to him. A record of every such transaction is made on the Application Sheets. Such a letter is illustrated on p. 295.

Return of Allotments.—Within one month of the completion of allotment, or within one month of any subsequent allotment, a return, bearing a 5*s.* stamp, must be filed with the Registrar in order to satisfy the requirements of S. 52 of the Act. The front page of this return is reproduced on p. 294, the other pages consist of a list of the names, addresses, and descriptions of the allottees with the number and class of shares held by them.

Allotment Letters.—After allotment has been made, an Allotment Letter is sent to each successful applicant. These documents must be stamped with 1*d.* if under £5, and with 6*d.* if over that amount. The posting of an allotment letter completes the contract to take shares as between the company and the applicant. An applicant may withdraw his application at any time prior to the posting of the letter, but not afterwards, unless he can prove misrepresentation in the prospectus or other irregularity entitling him to be relieved of his contract. An allotment letter is illustrated on p. 296.

Calls.—The prospectus of a new issue usually states the dates on which further instalments of the purchase price of shares are to be paid. For example, " The ordinary shares of £1 each shall be payable as follows: upon application, 2*s.* 6*d.*; upon allotment, 5*s.*; on October 25, 5*s.*; on November 25, 7*s.* 6*d.*" It is, however, not at all uncommon, especially where, as is very customary in recent years, the shares are of low denominations (say 1*s.* or 2*s.*) for the whole amount due on the share to be payable in one sum on application: this is equally the case where the shares are offered at a premium.

If no dates are specified, these instalments are payable at the discretion of the Directors after they have given due notice of the call, usually fourteen days or more. Under Table A and, as a rule, under special articles, no single call may exceed 25% of the nominal value of the share, and calls are made at intervals of two months. (Under Table A the interval must be at least one month.) Shares with an uncalled liability attached to them are not popular, except, perhaps, in the case of bank shares. Calls are specialty debts, and are therefore not statute barred until after the lapse of twenty years. It would appear that calls must be made on the subscribers to the Memorandum. Apparently they are not liable to pay for their shares until calls have been made upon them (*Alexander* v. *Automatic Telephone Co.*). A specimen call notice appears on p. 297.

Making a Call.—When the Directors have passed the necessary resolution making a call, a *Call List* should be prepared in the form appearing on page 298.

Large companies open a separate banking account and a subsidiary Cash Book for each call in the manner already described in the case of application and allotment moneys. In the financial books, a journal entry is made debiting the Call Account and crediting Share Capital Account with the total amount of the call. When the cash received has been posted to the credit of Call Account, the balance (if any) that remains will represent unpaid calls.

[*Continued at foot of p* 297.

RAYON D'OR, LIMITED.

(*Incorporated under the Companies Act*, 1948.)

This form must be sent *entire* direct to the Company's bankers, the National Provincial Bank, Ltd., Princes Street, London, E.C., together with a remittance for the deposit of *2s. 6d.* per share on the shares applied for. Cheques should be made payable to the Bankers, *or Bearer*, and crossed "Not Negotiable."

To the Directors of Rayon d'Or, Ltd.

Gentlemen,

Having paid to your Bankers, the National Provincial Bank, Ltd., the sum of £ : : , being a deposit of 2*s.* 6*d.* per share on .... shares, which I hereby apply for, I request that you will allot to me such shares, upon the terms of the Company's Memorandum and Articles of Association and the prospectus issued by you and dated .... 19...

I hereby undertake to accept such shares, or any less number you may allot to me, and I authorise you to place my name on the Register of Members of the Company in respect of the shares allotted to me.

Signature of Applicant ....

Name (in full) ....

Address ....

....

Occupation ....

(A lady should state whether Spinster, Wife, or Widow.)

Date .... 19...

------------------ (*Perforation.*) ------------------

(Bankers' Receipt, to be detached and returned by Bankers.)

Rayon d'Or, Limited.

Received this .... day of .... 19... of M.........................
.... the sum of .... being 2*s.* 6*d.* per share upon ....
shares applied for in the above Company.

For the National Provincial Bank, Ltd.

Stamp.

£ : :

Cashier

The receipt must be preserved by the applicant, to be exchanged in due course for the share certificate.

ISSUE OF 50,000 ORDINARY SHARES OF £1 EACH.

APPLICATION AND ALLOTMENT SHEETS.

Date of Application.	No. of Application.	Name of Applicant.	Address.	Occupation.	No. of Shares Applied for.	Amount Paid on Deposit ... per Share.				Date of Allotment.	No. of Shares Allotted.	Distinctive Numbers.		No. of Allotment Letter.	Amount Payable on Application and Allotment.			
						C.B. folio.	Amount.					From	To		Date Paid.	Amount.		
							£	s.	d.							£	s.	d.
												Note. In cases where there are several classes of shares, it is advisable to carry the numbering through continuously: *e.g.* Ordinary Shares, 1 to 100,000; Preference Shares, 100001 to 200000, and so on. This prevents confusion between the different classes of shares in subsequent transfer work.						

Date and No. of Letter of Regret.	Amount returned to Applicant.					Amount Paid in Advance of Calls.			No. of Share Certificate.	Folio in Share Register.	Remarks.	Balance due on Allotment.				
	Date.	C.B. folio.	Amount.									Date Paid.	C.B. folio.	Amount.		
			£	s.	d.	£	s.	d.						£	s.	d.
											Note. This column is used specially to earmark any forms bearing the initials of the directors or other applications which need special consideration.					

Number of Company .... [Form No. 45.]

THE COMPANIES ACT, 1948.

RETURN OF ALLOTMENTS

OF

...., LIMITED,

from the †......... day of ...., 19 ,
to the .... day of ...., 19 ,

A Companies Registration Fee Stamp of 5s. must be impressed here.

Made pursuant to Section 52, Sub-section 1, of the Companies Act, 1948.

(To be delivered to the Registrar of Companies within one month after the Allotment is made.)

*Number of the .... Shares allotted payable in Cash . ...
*Number of the .... Shares allotted payable in Cash . ...
*Nominal Amount of the .... Shares so allotted . . £.........
*Nominal Amount of the .... Shares so allotted . . £.........
*Amount paid or due and payable on each such .... Share £.........
*Amount paid or due and payable on each such .... Share £.........
Number of Shares allotted for a consideration other than Cash ....
Nominal Amount of the Shares so allotted . . . . . £.........
Amount to be treated as paid on each such Share . . £.........

* Distinguish between Preference, Ordinary, Redeemable Preference, or other descriptions of shares.

The consideration for which such Shares have been allotted is as follows:—

....
....
....
....

† *Note.*—In making a return of Allotments it is to be noted that—

1. When a return includes several Allotments made on different dates, the dates of only the first and last of such Allotments should be entered at the top of this page, and the registration of the return should be effected within one month of the first date.
2. When a return related to one Allotment only, made on one particular date, that date only should be inserted and the spaces for the second date struck out and the word " made " substituted for the word " from " after the name of the Company.

(Letter of Regret.)

irectors:
(Names)

RAYON D'OR, LTD.,
962 FINSBURY CIRCUS,
LONDON, E.C.
January 14, 19...

Enclosure.

SIR (or MADAM),

I am instructed by the Directors of the above Company to express gret that they are unable to allot any shares to you in response to your applica-on of ....

Enclosed I have pleasure in handing you a cheque for £ being e amount paid by you on application.

Kindly sign the receipt attached at the foot hereof and present the enclosed eque for payment in due course.

Yours faithfully,
ROBERT WOOD,
Secretary.

....
....
....

-- *(Perforation.)* --

. 3841.

LONDON .... 19...

THE NATIONAL PROVINCIAL BANK, LTD.

Pay to .... or Order, the receipt below being duly signed.
sum of £ : : .

For and on behalf of
RAYON D'OR, LTD.
JAMES BURGET, *Director*
ROBERT WOOD, *Secretary.*

-- *(Perforation.)* --

RECEIPT.

RECEIVED from Rayon d'Or, Limited, the sum of £ being the unt deposited by me on application for .... shares not allotted.

Receipt Stamp.

(*Allotment Letter.*)

RAYON D'OR, LIMITED.

Directors: (Names)

(*Incorporated under the Companies Act,* 1948.)

ISSUE OF 50,000 ORDINARY SHARES OF £1 EACH.

No. ....

ALLOTMENT LETTER.

Impressed 6d. Stamp.

962 FINSBURY CIRCUS,
LONDON, E.C.
January ...... 19...

....
....
....

SIR (or MADAM),

In reference to your application, I beg to inform you that .... ordinary shares of £1 each in the Capital of the above Company have been allotted to you by the directors.

	£ s. d.
The amount payable on application and allotment, viz. 5*s.* per share on .... shares is . . .	....
You have already paid on application . . .	....
Making the amount due from you upon allotment .	£...............

This amount is now due from you, and should be paid forthwith to the Company's Bankers, the National Provincial Bank, Ltd., Princes Street, London, E.C. Due notice will be given when the share certificates are ready, and they will then only be delivered in exchange for this letter, accompanied by the receipts from the Bankers for amounts paid on application and allotment.

By Order of the Board,

....
Secretary.

This form must be forwarded *entire*, together with remittance, to the Company's Bankers, The National Provincial Bank, Ltd., Princes Street, London, E.C., who will return it duly receipted. Cheques should be made payable to "Bearer" and crossed "Not Negotiable".

-------------------- (*Perforation.*) --------------------

BANKER'S RECEIPT FOR ALLOTMENT MONEY.

RAYON D'OR, LIMITED.

RECEIVED this .... day of .... 19..., the sum of £ : : , due in respect of allotment No. ....

THE NATIONAL PROVINCIAL BANK, LTD.

Stamp.

£ : :

Cashier.

-------------------- (*Perforation.*) --------------------

(*This slip to be detached and retained by Bankers.*)

RAYON D'OR, LTD.

ALLOTMENT.

No. ....

Amount £ : : .

.... day of .... 19...

An alternative Bankers' receipt for shares paid in full upon allotment is sometimes attached, where such payments have been invited.

(Call Letter.)

No. 36.

RAYON D'OR, LIMITED,
962 FINSBURY CIRCUS,
LONDON, E.C.

Directors:
(Names)

July 4, 19...

ORDINARY SHARES.

DEAR SIR (or MADAM),

I beg to inform you that in accordance with a resolution of the Directors dated July 2, 19..., a call of 5s. per share on the above shares has been made.

The amount due from you in respect of the 100 shares standing in your name is £25 0 0, and this amount should be sent on or before July 18, 19..., together with this notice *entire* to the Company's Bankers, the National Provincial Bank, Ltd., Princes Street, E.C., who will receipt and duly return this notice.

If you will forward the receipt attached hereto, together with your share certificates, the payment of the call will be endorsed, and the certificate returned to you.

By order of the Board,
James Conolly,
Secretary.

GEORGE DIXON, ESQ.,
1754 CANNON STREET,
E.C.

All cheques should be made payable to BEARER and crossed "Not negotiable."

No. 36.

RECEIVED for account of Rayon d'Or, Limited, the amount of the abovementioned call as stated.

For National Provincial Bank, Ltd.,
Robert Craig,
Cashier.
Date, *July* 18, 19...

---

o. 36.

RAYON D'OR, LIMITED.

Call of 5s. per share on issue of 100,000 Ordinary Shares.

£25 0 0

Date, July 18, 19...

ontinued from *p.* 291.]

Moneys due under the terms of a prospectus are more frequently nd properly termed "Instalments," as they are not actual calls made y the Directors.

The Directors' power to make calls is in the nature of a trust to be xercised for the benefit of the company. Calls must be made on all hareholders alike. No call can be made on some of the shareholders hile others go free. A call can, of course, be made on one *class* of are and not on other classes. To create liability on the part of the shareholders, the call must be made by directors duly appointed, and qualified, at a meeting duly convened, a quorum being present, by a resolution duly passed, specifying the amount, and time and place of payment; though trifling irregularities will not invalidate the call. Calls date from the day the resolution is passed by the Directors making the call, but notice must be given to the shareholder.

Calls in Advance.—The Articles of most companies provide that calls paid in advance shall carry interest, usually at 4% p.a. Table A of the 1929 Act provides that the Directors may accept money in advance of calls, and may pay thereon such interest (not exceeding 6% p.a. without the sanction of a general meeting) as may be agreed upon between the members concerned and the Directors. Table A of the 1948 Act restricts the rate to 5%. Calls in advance may not be accepted merely to pay Directors' fees, they must be for the benefit of the company as a whole (*Sykes's Case*, 1872). Calls so paid are really loans, and interest is payable on them even if no profits are made. Calls paid in advance do not carry any dividend rights, as they do not form part of the company's called-up capital, unless, of course, the Articles provide otherwise. In the event of liquidation calls in advance are repayable before payment is made on the amounts called up on the shares, but no refund of such moneys may be made while the company remains a going concern.

Calls in Arrear.—As a general rule, the Articles provide that members in arrear with their calls are not entitled to vote, and are liable after due notice to be charged with interest at a fixed rate. Table

CALL LIST.

Second Call of 2*s*. 6*d*. per Share. Date of Call, *March* 1, 19... Due *March* 17, 19...

Number of Call Note.	Folio Register of Members.	Shareholder.	Address.	Shares Held.	Amount of Call.			When Paid.				C.B. Folio.	Remarks.
								Amount.			Date.		
					£	s.	d.	£	s.	d.			
3	*47*	*Robinson, William*	*436 Duke Street, E.C.*	*120*	*15*	*0*	*0*	*15*	*0*	*0*	*Mar. 14*		

A provides for 5% p.a. from the day appointed for payment to the time of actual payment, but gives the Directors power to waive the interest wholly or in part.

Share Certificates.—When the shares issued have been fully paid, or, if partly paid, when there is no immediate intention of calling up the balance remaining on them, share certificates are issued to members. Share certificates must, in any case, be completed and ready for delivery within two months of allotment or transfer unless the conditions under which the shares were issued otherwise provide (S. 80). They are issued under the common seal of the company, and are *prima-facie* evidence that the person named in them is the owner of the number of shares specified. Usually, they are signed by two Directors and the secretary. Prior to the issue of the certificates, a notice is sent to members that the certificates will be handed or posted to them in exchange for the allotment letters and bankers' receipts for the instalments paid on the shares, or, in the case of some transfers, in exchange or the balance ticket. The allotment letters, or balance tickets, are hen cancelled and filed in order. A specimen share certificate is given below.

Share Certificate Book.—This book consists of pages divided by perforation into three parts: the first counterfoil records details of he number and date of the certificate; the name and address of the hareholder; the number of shares and their distinctive numbers. The second counterfoil is a form of acknowledgement, to be signed by the shareholder, of the receipt of the certificate. The third part s the certificate itself. The receipt counterfoil and the certificate re sent to the shareholder who signs and returns the receipt, which s then attached to the relative first counterfoil.

(*Share Certificate.*)

o. 362 100 SHARES.

RAYON D'OR, LIMITED.

(Incorporated under the Companies Act, 1948.)

CAPITAL £100,000 : 0 : 0, in 100,000 SHARES OF £1 EACH.

This is to Certify that *Lionel Robert Clare*, of *The Beeches, Maidenhead*, the Registered Proprietor of *100* Shares of £1 each, FULLY PAID, numbered *1* to *o* inclusive, in RAYON D'OR, LIMITED, pursuant to the Memorandum and ticles of Association of the said Company.

SEAL

Given under the Common Seal of the Company
this *25*th day of *March*, 19...

John Straight
George Dickson } Directors

ilip Roberts, Secretary.

Note.—No Transfer of any of the Shares comprised in this Certificate will be gistered until the Certificate has been delivered at the Company's Office.

Share Warrants.—If sanctioned by the Articles, share warrants to bearer, under seal of the company, may be issued in exchange for fully paid share certificates (S. 83). And the holder of a share warrant may return it to the company for cancellation and be entered in the Register as a member holding the shares specified in the warrant (S. 112). Share warrants are negotiable instruments, and can be transferred by simple delivery, no transfer in the company's books being necessary. Private companies cannot issue share warrants, since such companies must restrict the transfer of their shares. On exchange of share certificates for share warrants, the members are struck off the register. But, if the Articles so provide, the holder of a warrant may be deemed to be a member of the company either to the full extent or for any purposes defined in the Articles, except that he cannot act as a Director or Manager of the company in cases where the Articles impose a share qualification. Share warrants are impressed with a stamp representing three times the *ad valorem* transfer duty payable on the nominal value of the shares represented by the warrant. Payment of dividends on share warrants may be provided, and usually is provided, by means of coupons attached to the warrant. Share warrants are popular on the Continent, but are not extensively used in this country.

Provision of Financial Assistance by Company for Purchase of its own Shares.—It is illegal for a company to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security, or otherwise, any financial assistance for the purpose of, or in connection with, a purchase of shares in the company, unless the money is lent in the ordinary course of the business of a money-lending company, or in connection with a trust under a scheme for the benefit of employees, or to employees other than directors to enable them to acquire fully paid shares (S. 54).

Capital of a Company.—It will be useful at this point to deal with the terms descriptive of a company's capital, and the various classes into which it may be divided.

Authorised, Nominal or Registered Capital.—This is the maximum amount of capital which a company takes power in its Memorandum to issue (S. 2 (4)). A statement of this capital, made on the statutory form, must be registered with the Registrar and, in addition to registration fees, capital duty must be paid thereon at the rate of 10s.% (Finance Act, 1933, S. 41 (1)). The authorised capital may or may not be wholly issued; the issued capital may or may not be wholly subscribed; the subscribed capital may or may not be wholly called up; and the called-up capital may or may not be wholly paid up. The authorised capital is divided into shares, the denominational value of which is decided by the promoters of the company. Shares of £1 each are the most common, but denominations varying from 6*d.* to £100 may be met with; indeed, there are instances of companies being registered with a nominal capital of £1 divided into shares of ¼*d.* each! If shares are issued at too high a nominal value, it usually results in a restricted market for the shares. The same company may issue shares of different classes and different denominational values, as provided for in its Memorandum or Articles. The nominal capital may be increased or decreased in accordance with the provisions of S. 61 (*see* p. 272). It is the practice to state the nominal capital in the Balance Sheet "short." It does not appear in the company's financial books until it is issued and subscribed.*

Issued Capital.—This is that portion of a company's authorised capital which has been issued to the public for subscription, or to the vendors as fully or partly paid in exchange for assets acquired by the company. But all the capital issued for public subscription may not be taken up by the public.

Subscribed Capital.—This consists of that portion of the issued capital which is actually subscribed for by the public, or allotted to vendors in respect of assets conveyed to the company. Very frequently the subscribed capital is less than the authorised capital, because the whole authorised capital has not been issued for subscription, or has not been subscribed for by the public. The student will realise that the distinction between "Issued" and "Subscribed" capital is more academic than practical, in view of the fact that only the capital actually subscribed can be shown on the Balance Sheet.

Called-up Capital.—The called-up capital is that part of the subscribed capital which has actually been called up. The uncalled part of the subscribed capital, which represents the contingent liability of the shareholders on the shares, is known as the *Uncalled Capital.*

Paid-up Capital.—The paid-up capital is that part of the subscribed capital which has been called up and actually paid by the subscribers. The paid-up capital may be somewhat less than the called-up capital by reason of the failure of subscribers to pay the calls on shares for which they have subscribed. The difference between the called-up and the paid-up capital represents calls in arrear.

Reserve Liability.—By S. 60, a limited company may, by special resolution, determine that any portion of its share capital not already called up shall not be capable of being called up except in the event and for the purposes of liquidation. This method of providing a reserve, and so increasing a company's stability, has been adopted by some banks.

Working Capital.—Working capital is the amount by which the readily realisable, liquid, or current assets of a concern exceed its current liabilities. Thus, the total of a company's cash, investments, bills receivable, stock, book debts, and similar liquid assets *minus* its trade creditors, bank overdraft, bills payable, and similar floating liabilities represents the working capital of the company. In calculating such capital, ~~the fixed, and~~ more or less permanent assets, such as buildings, plant, etc., and long or fixed-period loans and similar "fixed" liabilities, are excluded.

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* In Scotland and certain foreign countries, an *Uncalled Capital Account* is opened for that part of the Issued Capital which has not been called, in which case the full nominal value of the Issued Capital is entered in the latter account. Certain companies also open up *Unissued Capital Accounts*, showing the full Nominal Capital in an account so called. These practices are not common in this country.

Loan Capital.—This is a term sometimes applied to debentures and other loans for fixed terms. The employment of the term is not happy, since these loans do not form part of a company's capital, and the regulations as to share capital contained in Companies Acts do not apply to them. They are liabilities, and the lenders are creditors, having no part or parcel in the company's affairs unless the instrument acknowledging the loan so provides, *e.g.* if the company makes default. The student should carefully note these distinctions.

Illustration.—Uprichards, Ltd., was registered with a nominal capital of £100,000, divided into 100,000 shares of £1 each. Of this amount 75,000 shares were offered to the public and fully subscribed. By December 31, 19..., 15*s.* per share had been called up and paid up, except that the last call of 5*s.* per share on 1,000 shares remained unpaid. Give the entries necessary to record these particulars in the Company's Balance Sheet.

BALANCE SHEET.

LIABILITIES SIDE ONLY.

	£	£
Capital—		
Nominal:—100,000 shares of £1 each	£100,000	
Issued:—75,000 shares of £1 each, 15*s.* per share called up	56,250	
Less Unpaid calls	250	
		£56,000

In this example, therefore:—

£

The Authorised (Nominal or Registered) Capital = 100,000
The Issued Capital . . . . . . = 75,000
The Subscribed Capital . . . . . = 75,000
The Called-up Capital . . . . . = 56,250
The Paid-up Capital . . . . . . = 56,000
The Uncalled Capital . . . . . . = 18,750
The Calls in arrear . . . . . . = 250

Classes of Shares.—Various classes of shares are commonly met with. These comprise: (1) Preference Shares divided into (*a*) Simple or Non-cumulative Preference Shares, (*b*) Cumulative Preference Shares, (*c*) Participating Preference Shares, (*d*) Pre-preference, or First Preference Shares, (*e*) Convertible Preference Shares, (*f*) Preferred Ordinary Shares; (2) Redeemable Preference Shares; (3) Ordinary Shares; (4) Deferred Ordinary Shares; (5) Deferred, Management, or Founders' Shares.

Preference Shares.—These usually rank first both as to payment of dividend and return of capital. Preference Shares may be issued carrying the first of these preferences only, but if they carry both, then: (*a*) the fixed rate of interest attached to the shares must be paid out of profits before the Ordinary Shares rank for dividend; (*b*) in the event of the company going into liquidation, preference capital has the right to prior payment before other classes of shares, should funds for repayment be available after payment of debts.

It would appear that a limited company has power to issue Preference Shares even when the Memorandum is silent on the point.

In the absence of provision to the contrary in the Memorandum or terms of issue, any surplus remaining after all share capital has been repaid must be divided amongst all shareholders (*Anglo-French Music Co.* v. *Nicol*, [1921]). But where the rights of Preference Shareholders are precisely set out in the Memorandum, this may bar their right to share in such surplus (*Collaroy Co.* v. *Giffard* [1928]).

Simple or Non-Cumulative Preference Shares.—These are preference shares, which carry a preferential right to dividend out of the profits of each year only, that is so far as profits are available to pay the dividend. The decision as to what profits are available rests with the directors. These shares have no claim on the profits of succeeding years should the profits for any year be inadequate to pay the dividend. Care should be taken to make it clear that the shares are non-cumulative, otherwise subscribers are entitled to assume that they are cumulative.

Cumulative Preference Shares.—With this class of share, the preferential rights to dividend accumulate from year to year in the event of the non-payment of dividend, the arrears of one year being carried forward to the next, and so on. Thus, if a company issued 6% Cumulative Preference Shares, and made insufficient profits to pay the dividend upon them for four years, it would have accumulated a liability to pay four years' dividend at 6% p.a., as and when sufficient profits were available to meet these claims, before any dividend could be paid to the holders of subordinate classes of shares. In cases of this sort, a note must be made on the Balance Sheet (Eighth Schedule, para. 11 (3)) stating: (*a*) the amount of the arrears, before deduction of income tax, and (*b*) the period during which the dividend is in arrear. If there are several classes of such shares these particulars must be stated for each class separately. Since the liability is contingent upon sufficient profits being earned to meet it, and on dividends being declared, no entries can be made in the books of the company.

If the Articles are silent on the point, Preference Shares are assumed to be cumulative.

Under Table A, unless special rights are attached to the shares, all dividends are payable only on the amounts actually paid up on the shares, but under some Articles, and in all cases where Table A is barred, and the special Articles make no provision, dividends are payable on the nominal amount of the shares * (*Oakbank Oil Co.* v. *Crum*, [1883]). Preference Shares do not carry preferential rights as to capital repayment unless this right is expressly stated in the conditions of issue, and in the Memorandum and Articles.

Participating Preference Shares.—In addition to the advantages attaching to Cumulative Preference Shares, these shares carry a right to a stated share in the surplus profits after payment of the fixed dividend to which they are entitled, usually after a certain minimum has been paid on the subordinate classes of shares.

Pre-preference (or First Preference) Shares.—For the purpose of raising urgently needed capital, these shares are sometimes issued with the consent of the Preference Shareholders. As the name implies, the terms of issue (which must be *intra vires* the Memorandum and Articles) provide that the rights of the holders of such shares in respect of dividend and capital repayment stand in front of the rights of the holders of all other classes of shares.

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* This applies to all dividends—preference or otherwise.

Convertible Preference Shares.—These are Preference Shares, the holders of which have the right to have them converted into another class of share, *e.g.* Ordinary or Deferred, within a specified time.

Preferred Ordinary Shares.—Holders of these shares have the right to a fixed dividend after the claims of the Preference Shareholders have been met, and before the Ordinary Shares rank for dividend. They are always non-cumulative.

Redeemable Preference Shares.—A company limited by shares may, if so authorised by its Articles, issue Preference Shares which are, or at the option of the company are to be liable, to be redeemed. No such shares may be redeemed except out of the profits of the company which would otherwise be available for dividend, or out of the proceeds of a fresh issue of shares made for the purpose of the redemption. Such shares can be redeemed only when fully paid. When they are redeemed otherwise than out of the proceeds of a fresh issue, there must be set aside, out of profits which would otherwise be available for dividend, a sum equal to the amount applied in redeeming the shares to a reserve fund called "the *Capital Redemption Reserve Fund.*" The provisions of the Act as to reduction of share capital apply to such a fund as if it were share capital. If the shares are redeemed out of the proceeds of a fresh issue, any premium payable on redemption must have been provided for out of profits or out of the company's Share Premium Account (S. 58 (1)).

Every Balance Sheet must specify what part of the issued capital consists of Redeemable Preference Shares and the date on or before which these shares are, or are liable, to be redeemed (Eighth Schedule, para. 2 (*a*)).

If a company has redeemed or is about to redeem any Preference Shares, it may issue shares up to the nominal amount of the shares redeemed or to be redeemed as if those shares had never been issued, and no stamp duty is payable on such amount provided the old shares are redeemed within one month after the issue of the new shares (S. 58 (4)). The Capital Redemption Reserve Fund may then be applied (up to the nominal amount of the shares so issued) in paying up unissued shares of the company to be issued to members as fully paid bonus shares.

For example see p. 300.

Ordinary Shares.—The bulk of the shares issued by most limited companies are of this class. Ordinary Shares carry no special rights as to dividend or capital repayment. Generally, they are entitled to the surplus profits remaining after the prior fixed dividends, enumerated above, have been satisfied. But they may be subject to the rights attaching to Deferred Ordinary Shares, if such exist.

Deferred, Management, and Founders' Shares.—These shares are usually issued as fully paid to the promoters, or managers, of the issuing company. As regards dividend, they usually stand aside until an agreed dividend has been paid on the Ordinary Shares. Particulars of Founders', or Deferred, Shares must be stated in the Prospectus

(Fourth Schedule, Part I, para. 1). Though generally few in number and insignificant in nominal value, the voting powers which they command and the profits they share are often considerable. They are not popular with the investing public, since they do not always tend to prudent management, the holders being usually desirous of dividing all available profits without much regard for the prudent building up of reserves. The issue of these shares is, however, probably the most scientific method of paying for goodwill, since the value of this asset largely depends upon the profits earned being in excess of a certain minimum. But where such shares are issued in payment for the goodwill, an equitable number of similar shares should be issued to the shareholders of other classes who run the real risk of the business.

Bonus Shares.—Successful companies sometimes issue shares in lieu of increased dividends. The usual procedure is to declare a dividend, credit the shareholders with the dividend, and then to issue shares in discharge thereof, no money passing on either side (*see* p. 378). Bonus Shares may be of any of the classes described above. The provisions regarding the issue of Bonus Shares where Redeemable Preference Shares have been redeemed should also be referred to on p. 390.

Co-Partnership Shares.—These shares are sometimes issued to a company's employees in order to give them an interest in the concern. Frequently, such shares carry no voting power. They are usually entitled to the same dividend rights as the Ordinary Shares, but their transfer is usually under the control of the company, and effected at a fixed price. Sometimes *Profit-Sharing Certificates* are issued to employees. These have no capital value, but entitle the holders to dividends upon an assumed capital value stated on the face of the certificate. Such certificates cannot be sold, and must be surrendered to the company on demand.

EXAMINATION QUESTION.

What is the difference between a "Cumulative" and a "Non-Cumulative" Preference Share? Does this difference affect the annual accounts in any manner? (*London Chamber Commerce.*)

Answer.

Cumulative Preference Shares are shares which carry preferential rights to dividend, usually ranking before all other classes of shares. In addition, in the event of the available profits in any year proving insufficient to meet the fixed preference dividend, the arrears *accumulate*, and no dividend can be paid on shares having subordinate rights until these arrears have been discharged. No obligation, however, exists to pay the cumulative preference dividends, unless sufficient profits are available to discharge them, *and dividends are declared.* The Memorandum and Articles and the terms of issue usually provide that, in the event of liquidation, after the costs of the liquidation have been met, and the secured and unsecured creditors have been satisfied, the surplus assets shall be applied first in paying off any arrears of cumulative preference dividend, then in repaying the Preference Share capital.

Non-Cumulative (or Simple) Preference Shares possess no right to the accumulation of dividends, and in the event of dividends being passed, or only partially satisfied, the holders of these shares have no claim upon the profits of subsequent years for arrears of dividend. Each year stands alone. These shares usually have a right to repayment of capital in priority to holders of other classes of shares, subject, of course, to the rights of the holders of any shares of a higher class which may have been issued.

Preference Shares are cumulative unless it is clearly otherwise stated in the Memorandum, or, if the Memorandum is silent, in the Articles or in the Terms of Issue.

Treatment in the Annual Accounts.—In the case of Cumulative Preference Shares, a note of dividends thereon which have been passed should be made on the face of the Balance Sheet if any arrears of dividend exist, otherwise the holders and prospective holders of shares of this and subordinate classes of shares may be prejudiced. No such note is required in the case of non-cumulative shares, as dividends which have been passed are not payable out of subsequent distributions of profit.

Issue of Shares at a Discount.—A company can issue at a discount shares of a class already issued, in certain circumscribed circumstances, viz.:—

(*a*) the issue must be authorised by resolution passed in general meeting of the company and sanctioned by the court;

(*b*) the resolution must specify the maximum rate of discount;

(*c*) not less than one year must have elapsed since the date on which the company was entitled to commence business;

(*d*) the shares must be issued within one month after the date on which the issue was sanctioned by the court, or such extended time as the court may allow.

The court may make terms and conditions when sanctioning the issue. Particulars of the discount allowed, or of so much as has not been written off, must appear in every prospectus relating to the issue, and in every subsequent Balance Sheet (S. 57 and Eighth Schedule, para. 3 [*e*]) (see p. 358).

Stock.—Subject to the necessary authority being contained in the Articles, companies may convert their shares (but only if fully paid) into stock (S. 61 [1] (*c*)). Stock may also be converted back into shares.

Numbering of Shares.—Every share in a company having a share capital must have a distinguishing number. But, provided that all the shares of any particular class are fully paid and rank *pari passu*, the distinguishing numbers of such shares may be dispensed with so long as the proviso is satisfied. This last is a new provision introduced by the 1948 Act (S. 74), and a number of companies have already commenced to take advantage of it on account of the saving of clerical labour in recording transfers and making entries in the register of members. The effect is very much the same as converting the shares into stock (see below).

A great number of public companies now use this power, as perusal of the official *Daily List* of the London Stock Exchange will show. The differences between shares and stock are:—

(1) Shares may or may not have distinctive numbers; stock *cannot* have a distinctive number.

(2) A share whether numbered or not is a definite unit, having a stated denomination. Stock, while it may as a matter of convenience

be divided into units, is not necessarily so. An illustration will make this clearer:—

Illustration.—Uprichards, Ltd., was registered with a capital of £50,000, divided into Ordinary Shares of 10*s.* each, and 200 of these shares were allotted to John Brown. At one time these shares were all partly paid, and at that stage they had to have distinctive numbers, the numbers of Brown's shares being (say) 23,101 to 23,300 inclusive. These distinctive numbers would have appeared: (1) in the register of members, (2) on Brown's share certificate, and (3) on any transfer of the shares. In due course the shares were fully paid up, and the company thereupon decided to take advantage of S. 61 (*c*) and convert them into stock. On this taking effect the capital of the company becomes £50,000 Ordinary Stock, of which Brown holds £100, *i.e.* £1 nominal of stock for each two shares he had before. There would be nothing to prevent Uprichards, Ltd., permitting the transfer of its stock in any quantity or fractions, so that Brown could transfer £19 17*s.* 3*d.* of his holding to his friend James Evans if he desired; however, this would lead to a good deal of clerical inconvenience and tend to nullify the advantage of converting the shares into stock, so that in practice the resolution which converts the shares into stock will provide also that the stock shall be transferable only in multiples of a selected unit. This unit will normally be the value of stock equal to the nominal value of each share before conversion, and if the company has a stock-exchange quotation it will be for the "stock unit." On this basis Uprichards, Ltd., now has a capital of £50,000 in stock, divided for purposes of transfer into 100,000 stock units of 10*s.* each. Brown is the owner of £100 stock, equivalent to 200 units, and if the stock-exchange quotation is (say) 14*s.* 3*d.*, this will be the value not per £1 of stock but per 10*s.* of stock. The point can be a pitfall for the unwary.

The above remarks refer only to the stocks of limited companies. The stock-exchange quotations of British Government and Colonial, and many foreign government, Stocks, and the Stocks of corporations and public boards, etc., are quotations per nominal £100 of the stocks in question. British Government Stocks are usually transferable in odd amounts, *i.e.* in any multiple of a penny.

Stock cannot, of course, bear distinctive numbers, and it is equally obvious that it must be fully paid up. In other respects both shares and stock possess the same characteristics. Dividend rights, priority of capital repayment, and so on, may be identical in both cases.

Kinds of Stock.—Just as there are several classes of shares so there are several classes of stock. *Preferred Stock* is a term which is self-explanatory. *Guaranteed Stock* is stock that is guaranteed both as to capital and dividend by some Government or outside Corporation. *Deferred Stock* is stock the dividends on which are deferred in favour of prior classes of stock. *Inscribed Stock* is stock, the title to which consists in the names of the holders being "inscribed" in the books of the Bank of England or other bank or authority managing the stock, instead of being evidenced by certificates.

Government Stocks.—Government indebtedness may be recorded in any one of three forms, bearer bonds, registered stocks, or inscribed stocks. Bearer bonds are complete documents of title in themselves, and since they belong to "bearer" contain no record of the holder's name, nor can any register be kept of the names of holders. They are transferable by mere delivery, subject to possible temporary restrictions, such as those imposed by the Exchange Control Act, 1947.

Registered and inscribed stocks are recorded on behalf of the

Government by the Bank of England, who in effect act as registrars for the Government in just the same way as various professional bodies or institutions often act as registrars for limited companies. Incidentally the Bank of England performs similar duties for various colonial governments in addition to the British Government, and most of such governments, in addition to municipal corporations and public boards, employ one or other of the British Banks, or British branches of Colonial banks, to carry out the same function in relation to their stocks.

As stated above, British Government Stocks may in general be in either inscribed or registered form. Colonial stocks are generally, according to the terms of issue, either all in the one form or all in the other. The difference between the two forms is as follows:—

The title to a registered stock is evidenced by a Stock Certificate made out in the name of the owner, which is evidence that the named person is entered as the owner of so much stock in the register kept by the bank. Transmission of title is carried out by executing a transfer in exactly the same form as is used for transferring shares or stock of a limited company, and the completed transfer and the old Stock Certificate must be delivered to the bank, who will in due course register the transfer and issue a fresh certificate in the name of the new holder. The holding of the certificate is evidence of title (and will be accepted as such by an auditor), and the bank will not register a transfer unless the old certificate is produced for cancellation.

In the case of inscribed stocks no document of title exists: the actual title consists in an entry on the bank's register and there is no "Stock Certificate." On a transfer being recorded, the bank will issue to the new holder a document, called a stock receipt, but this is merely evidence that an entry has been made: it will not be produced or given up if the holding is subsequently transferred to a new holder, and is therefore valueless as evidence of title. On a sale being made the original holder must either attend in person at the Bank of England with suitable evidence of identity to sign a transfer in the books (probably almost never done in practice) or sign a Power of Attorney authorising an agent to do so: the normal practice is for the seller's stockbroker to act as agent for this purpose.

For audit purposes, inscribed stocks are verified by the holder signing a form addressed to the bank requesting it to confirm (to the auditor or person named) that the holding was, on the date stated, inscribed in the name of the stated holder: the bank will certify the correctness of the entry and forward the form to the person named on it. No fee is charged for this service in respect of British Government Stocks: in respect of some other stocks a small fee may be payable, usually 1*s.* 0*d.*

British Government Stocks are normally convertible, at the holder's request, from one form to another. During the recent war, however, the practice of inscribing stock was discontinued, for security reasons: if a holding was already in inscribed form it remained so, but if an inscribed holding was transferred to a new holder that holder received a Stock Certificate, and his holding was in registered form.

Borrowing Powers of a Company.—Even successful companies are sometimes in need of cash. Temporary shortage of working capital, heavy purchases of stock or raw material to take advantage of a favourable market, the need for granting extra credit to tide over a period of trade depression, these and other circumstances may create the necessity to borrow. Trading companies have an implied power to borrow, if such borrowing is properly incidental to the conduct of the business (*General Auction Estate Co.* v. *Smith*, [1891]), and to pledge their assets as security (*Re Patent File Co.*, [1871]), even when no powers are taken so to do in the Memorandum. There are no statutory limits to a trading company's borrowing powers, but they are usually defined in the Memorandum or Articles, and are frequently limited to an amount not exceeding the issued capital of the company. Non-trading companies have no power to borrow or to pledge their assets, in the absence of express power so to do in the Memorandum. If a stock-exchange quotation is sought, the articles must fix a reasonable limitation to borrowing powers, any extension thereof being subject to control by the company in general meeting.

Debentures.—Companies frequently raise money by means of loans for fixed periods, repayment of which is generally secured to the lender by some charge on the company's assets. Loans are frequently evidence by documents termed *Debentures*. It has already been stated that these loans do not form part of a company's capital, as is sometimes erroneously supposed. A shareholder is a *proprietor* or *partner* in the company; a debenture holder or other lender is a *creditor* of the company, and the interest on the loan accrued due to him is payable whether the company makes profits or not. Although he is not a member, every debenture holder, even of a private company (excepted under the 1929 Act) must receive the company's audited accounts. They must be sent to him not less than twenty-one days before the meeting at which the accounts are to be presented, notwithstanding that he may not be entitled to attend the meeting (S. 158).

Definition of Debenture.—There is no precise statutory definition of a debenture, but it may be defined as "a document issued, usually under seal, by a company to a creditor in respect of money lent by him to the company, to secure the payment of interest at the rate and on the sum specified therein, and repayment of the capital." There is no statutory form of debenture, but a form in common use is shown on p. 311.

Nature of Debenture Charge.—A debenture may create a specific charge on some particular asset of a company, *e.g.* its freehold factory. In that case the debenture is said to create a *Fixed Charge* on the particular property. The modern debenture usually covers the whole of the property of the company "whatsoever and wheresoever both present and future including its uncalled capital." A charge of this kind covers all the company's assets, including those which fluctuate in value from day to day, such as book debts and stock, and is called a *Floating Charge*. It does not prevent the company from dealing with such assets in the ordinary course of business, but it creates a charge upon them as against other creditors. All debenture issues secured by any charge must be registered with the Registrar of Companies.

Kinds of Debentures.—Various kinds of debentures are to be met with in practice. *First Mortgage Debentures ; Second Mortgage Debentures*, as the names indicate, rank in the order of issue. The holders of the first issue must be satisfied in priority to the holders of the second, and so on. *Registered Debentures* are debentures which are registered in the books of the company, and, therefore, capable of transfer in a similar way to shares. *Bearer Debentures*, on the other hand, are negotiable instruments capable of transfer by mere delivery. In this country, the majority of debentures are registered, but in other countries bearer debentures are almost exclusively employed. *Naked* or *Simple Debentures* afford no charge on the property of the issuers, and the holders of such debentures are therefore unsecured creditors. They are uncommon except as acknowledgments of loans for short periods. *Irredeemable (Perpetual) Debentures* are debentures the capital sum secured by which is not repayable except in the event of the company ceasing to exist. They are really perpetual annuities. *Debenture Stock* represents debentures consolidated into one stock, or "one mass for the sake of convenience" (Lord Lindley), just as fully paid shares may be consolidated into stock. Debenture stock must be fully paid, and may be transferred in agreed fractions. Almost invariably, debenture stock is covered by a charge on the assets.

Issue of Debentures.—Debentures may be issued at par, or at a discount, or at a premium. Shares may be issued at par or at a premium, but may be issued at a discount only under S. 57 (see p. 358) and not otherwise. Debentures must not be issued at a discount if there is power to exchange them before the maturity of the debentures for fully paid shares other than those issued at a similar or less discount under S. 57, for that would be a method of illegally attempting to issue shares at a discount. There is, however, nothing to prevent, *e.g.* the conversion of a £100 debenture issued at 95 into 95 £1 Preference Shares or into 100 Preference Shares of £1 with 19s. paid up, or into Shares issuable under S. 57 at a discount of not less than 5%.

Form of Debentures.—In this country, debentures are usually registered, and recorded in the Register of Debenture Holders in a similar way to the record of shares in the Share Registers. Certificates (or bonds) are issued in respect of them. Debentures are transferable in common form by deed. Where bearer bonds are issued they have interest coupons attached, and are transferable by delivery alone.

Interest on Debentures.—Debenture interest is payable quarterly, half-yearly, or yearly, half-yearly payments being the most usual. Cheques (or warrants) are posted to the holders of registered bonds for the interest due, less tax at the current rate. Bearer debentures carry a perforated sheet of detachable *coupons* covering each payment of interest due over a number of years. These are detached on the due dates and paid in, like cheques, to bankers for collection. If the sheet of coupons does not cover the "life" of the debenture, a slip, called a *Talon*, is attached as a voucher entitling the holder to a fresh sheet of coupons. When the coupons have been paid by the company, they are usually pasted into albums, similar to stamp albums, representing each dividend paid.

Trust Deed.—The security supporting a debenture issue, and the terms of issue, are usually set forth in a document called a *Trust Deed*, by which the company's properties are charged in favour of certain nominees, termed *Debenture Trustees.* These trustees represent the debenture holders and safeguard their interests. Sometimes a deed is dispensed with, and the debentures themselves contain the charge. But such a deed is essential in the case of debenture stock. Debenture holders may demand a copy of the trust deed, if printed, on payment of 1*s.*; if not printed, they may demand a copy upon payment at the rate of 6*d.* per 100 words.

The following is a form of debenture such as is used when there is no trust deed:—

UPRICHARDS, LIMITED.

Issue of [100] Mortgage Debentures of £[100] each numbered 1 to 100 bearing interest at £5 per cent. per annum payable on the first day of January and the first day of July in each year.

The issue is made pursuant to Clause 15 of the Company's Memorandum of Association and Article 36 of the Company's Articles of Association and a resolution of the directors passed on the fifteenth day of December, 19...

DEBENTURE.

No. 52.

£[100]

1. Uprichards, Limited, whose registered office is at 532 Oxford Street, London, W. (hereinafter called the Company), will, on the first day of January, 19..., or on such earlier day as the principal moneys hereby secured become payable under the conditions of this debenture, pay to *Miles Further, of Maidenhead, Berks.*, or other the registered holder hereof (hereinafter called the debenture holder, which expression shall, where the context so admits, include his personal representatives), the sum of £[100].

2. The Company will until payment of the said sum of £[100] pay to the debenture holder interest thereon at the rate of £5 per cent. per annum, by equal half-yearly payments on the first day of January and the first day of July in each year, the first payment to be made on the first day of July next [and to be calculated from the date hereof].

3. The Company hereby charges with the said payments its undertaking and all its property present and future, including uncalled capital and goodwill.

4. This debenture is issued subject to and with the benefit of the conditions indorsed hereon, which are to be deemed part of it.

Given under the seal of the Company this 31st day of December, 19...

The common seal of the above-named Company was affixed hereto in the presence of

Hugh Dickson } *Directors.*
George Dickson }
Abel Chatenay, *Secretary.*

[*Note.*—On the back, or following pages, are printed the conditions (*see* below).]

Conditions of Issue.—These usually contain provisions to the effect following:—

(1) The debenture is to be one of a series securing, say, £10,000 in all, and all the debentures of the series are to rank *pari passu* as a

first charge on the property and assets of the company without any preference or priority over one another.

(2) The charge to constitute a floating security on all the property of the company, but sometimes power is reserved for the company to mortgage specific assets, and on the purchase of any additional property to mortgage it to secure the whole or part of the purchase money; and so long as the charge is a floating charge (*i.e.* until the debentures become payable) the company may carry on its business and deal with its property as the company may think fit.

(3) There are provisions for a register of debentures, for transfers being in writing and delivered to and retained by the company; for the executor or administrator of a deceased debenture holder being the only persons recognised by the company as having any title to it; for a fee of 2*s.* 6*d.* to be paid for registration of any transfer or probate; and the company is to be entitled to treat the debenture holder as the sole and absolute owner, and no notice of any trust is to be entered on the register.

(4) Provisions are sometimes made that interest will be paid by cheques posted to debenture holders.

(5) There is the important clause dealing with the events on which the principal moneys become payable. These are usually the following:—

(*a*) If the company gives three months' notice of intention to pay off.

(*b*) If the company makes default for a stipulated period, such as fourteen days, in payment of interest, though it is usual to add the proviso that notice must be given requiring payment of the principal moneys before the interest is actually paid.

(*c*) If a distress or execution be levied or issued against the company.

(*d*) If an order is made for winding-up or a resolution passed to the same effect.

(6) Debenture holders are often given power to appoint a Receiver after the principal moneys have become payable. Such an appointment may be made as the condition is framed, either by all the debenture holders concurring or by the majority in value of the debenture holders. The person appointed Receiver may also be appointed Manager, and may have power to take possession of the property charged, carry on the business of the company, sell the security, and make any arrangement or compromise.

(7) There is usually a clause providing that the proceeds of sale be applied:—

(*a*) In payment of the expenses of and incidental to the appointment of the Receiver and the exercise of his powers and his remuneration.

(*b*) In payment to the debenture holders ***pari passu*** of all principal moneys.

(*c*) In payment of arrears of interest.
(*d*) Any surplus to be paid to the company.

(8) Sometimes a clause is added saying that the rights of the debenture holders may be varied with the consent of the holders of three-fourths of the debentures for the time being outstanding, the decision of that majority to be binding on the debenture holders. The rights of the debenture holders are subject to those of creditors whose claims are declared by S. 319 to be preferential in a winding-up (S. 94).

Where there is a large issue of debentures it is usual to have a trust deed. The provisions are similar in general effect to those given above. Specific property is often mortgaged to the trustees for debenture holders with or without a floating charge on other assets, and the powers of realisation and so forth are exercisable by the trustees.

Receiver Appointed by the Court.—Notwithstanding the existence of powers to appoint a Receiver without going to the Court, it is often advisable to apply to the Court, and it is necessary to do so where the ground of application is that the assets are in jeopardy (although there has not yet been any default by the company), for it is not usual for debenture holders to have power to appoint in such a case, which obviously is likely to give rise to differences of opinion.

There is also the advantage that a Receiver appointed by the Court is an agent of the Court, and interference with him amounts to contempt of court. If he enters into contracts in carrying on the business or for the purpose of realisation he is personally liable upon them, though with a right to be indemnified out of the assets.

Receiver Appointed by Debenture Holders.—A Receiver appointed by the debenture holders under the powers contained in the debentures is their agent, and they are liable upon his contracts. To avoid this it is usual to provide in the conditions that the Receiver when appointed shall be the agent of the company (in which case the company is liable on his contracts) and to embody the powers given to mortgagees by the Law of Property Act, 1925, and formerly by the Conveyancing Act, 1881. But even if the Receiver is made an agent for the company his powers to bind it cease when the company is ordered to be wound up, though he does not thereby become agent for the debenture holders. He should, therefore, for his protection obtain an indemnity from the persons appointing him before incurring serious liability, unless the assets are certainly sufficient to recoup him.

Registration of Debentures.—The requirement, stated below, that every mortgage by a company shall be registered, applies to debentures. Every mortgage or charge: (*a*) to secure debentures, (*b*) on uncalled capital, (*c*) which is given by an individual would require registration as a bill of sale, (*d*) on land, (*e*) on book debts, or (*f*) floating charge, (*g*) on calls made but not paid, (*h*) on a ship or any share in a ship, or (*i*) on goodwill, on a patent, or a licence under a patent, or on a copyright, or a licence under a copyright, is void unless registered within twenty-one days. The Court has power to allow subsequent registration, if the omission to register was due to accident or inadvertence, on such terms as it thinks fit.

The register (which is in fact a part of the file of the company's papers at Bush House) is open to inspection, so that persons dealing with a company may be able to ascertain whether it has mortgaged its assets.

A floating charge created within twelve months of the commencement of the winding-up is void unless the company immediately after the creation of the charge was solvent, except to the amount of any cash paid to the company at the time of, or subsequently to the creation of, and in consideration for, the charge, together with interest at 5% (S. 322).

Rights of Debenture Holders.—A debenture holder is entitled to have a copy of the trust deed by which they are secured and to inspect the register of debenture holders (S. 87) and to obtain the Balance Sheets of the company and the reports of the auditors (S. 158). He has also, when the principal money secured has become due, the ordinary rights of a creditor. He may sue for his debt, recover judgment and issue execution, or petition for the winding-up of the company. But as he is a secured creditor he is more likely to realise his security, which he does by the appointment of a receiver.

As soon as the principal moneys become payable and the debenture holders intervene, the "floating charge" is said to become fixed, or to attach. Until then the company can deal with its property; but the charge then attaches to all assets which have not been alienated.

Redemption of Debentures.—As stated above, some debentures, termed Irredeemable, are payable only in the event of liquidation. Other methods of repayment are: (*a*) *By Drawings* determined by ballot, the numbers drawn in the case of bearer bonds being advertised in the Press. (*b*) *On Demand*, a term that explains itself. (*c*) *At a Fixed Date, i.e.* at the date specified in the terms of issue. A company usually has power to anticipate this date. (*d*) *At the Option of the Company, i.e.* at any time fixed by the company, subject to due notice being given to the holders. (*e*) By *Purchase in Open Market*, provided that the company has reserved this power to itself. (*f*) By the *Issue of New Debentures*, the proceeds of which are used to pay off the old debentures.

Except when new debentures are issued to replace old, the necessary funds for the redemption of debentures may be provided out of capital, or profits, or from a fund accumulated for the purpose by outside investment, or from the proceeds of a capital-endowment policy.

Re-issue of Debentures.—By S. 90 debentures that have been redeemed may be re-issued unless any provision to the contrary, express or implied, is contained in the articles or in any contract entered into by the company, or the company has, by passing a resolution, or some other act, manifested its intention that the debentures shall be cancelled. Debentures so re-issued must be stamped as new debentures. But debentures deposited with a banker to secure advances on current account are not deemed to have been redeemed by reason only of the current account having ceased to be in debit while the debentures are so deposited. That is to say, the debentures are available without fresh stamping to secure future advances.

Notes.—A practice has arisen within recent years, and appears likely to spread, among limited companies of issuing "notes" in acknowledgment of moneys lent. These notes are issued under the seal of the company. They give no specific charge on the company's assets, and are usually repayable at definite dates, or by means of periodical drawings. The wording of the note will probably decide whether it comes within the category of a promissory note or a naked debenture—no legal guidance is yet available on the point. The holders of such notes are probably unsecured creditors. The amount outstanding under this heading should be separately stated in the Balance Sheet immediately after the item "Debentures," if any have been issued.

Example of Capital Issue.—The student is sometimes puzzled when confronted by the array of debentures and shares of various classes offered for subscription by some companies, and wonders why the simpler course of confining the capital issue to ordinary shares is not followed. The answer is that financial expediency, and not simplicity, is the governing factor.

Illustration.—Rayon d'Or, Ltd., is registered to purchase an old-established business. The purchase price of the assets and goodwill is £250,000. It is decided that £50,000 is required for working capital. The capital is therefore fixed at £300,000. The profits of the business for the past five years averaged £24,000. This figure shows 8% on the proposed capital, a not sufficiently attractive return on an undertaking of this class. There is also to be considered the investor who prefers a lower rate of return, provided that it is combined with the greater capital security that is offered by Debentures or Preference Shares. To meet the needs of all classes of investors, the following issues are decided upon:—

£	*Issue.*	*Interest Required.* £
100,000	5% Debentures	5,000
100,000	7% Cumulative Preference Shares .	7,000
	Leaving for dividend on	
100,000	Ordinary Shares at, say, 12% . .	12,000
£300,000		£24,000

Stock Exchange Quotation.—Most large public companies desire to have an *Official Quotation* on the London Stock Exchange for their shares and debentures. To obtain this quotation certain rules and formalities must be observed. These are too lengthy to set out here, but they have been dealt with in sufficient detail in the author's *Accounting*. Without an official quotation, the market for any particular stocks or shares is very restricted, and in a restricted market prices suffer. If the application for a quotation is successful, the company's shares will in due course be quoted in the *Stock Exchange List*, published daily, at the prices ruling at 3.30 p.m. on the day of publication; and similar information will appear in the financial columns of the Press.

EXAMINATION QUESTIONS.

1. Define the several kinds of companies which may be incorporated under the Companies Act, 1948. For what purposes, to what extent, and how may a company change: (a) its name, (b) its objects, (c) its Articles of Association?

2. In what events may the liability of a shareholder in a limited company become unlimited?

3. State briefly the main distinctions between a company limited by shares and a partnership.

4. What do you understand by a Statutory or Parliamentary company? State briefly wherein they differ from companies incorporated under the Act of 1948.

5. Describe the steps necessary for the actual formation of a new company. (*Royal Society Arts.*)

6. Briefly describe the differences which exist between a public and a private limited company. (*Royal Society Arts.*)

7. What is meant by a "private company" under the Companies Act, 1948? Mention some of the privileges and immunities conceded to such a company, and state how it may turn itself into a public company.

8. What limit is placed on the number of members of a private company? How is the private character of a company terminated?

9. What are the contents and functions of the Memorandum of Association of a company? (*Chartered Accountants.*)

10. Define the Memorandum. How far may it be altered or extended? (*Royal Society Arts.*)

11. How, and to what extent, may the objects clause in the Memorandum be altered? (*Chartered Institute Secretaries.*)

12. When may a company reduce its capital: (a) Without leave of the Court; (b) With leave of the Court?

What steps must be taken for reducing capital when the sanction of the Court is necessary? (*Incorporated Accountants.*)

13. What is the difference between the Memorandum and the Articles of Association of a company, and what in particular must be stated in the Memorandum? To what class of companies, and to what extent, do the regulations of Table A apply? (*Incorporated Accountants.*)

14. What are the provisions of the Companies Act, 1948, with respect to the: (a) Registration of Articles; (b) application of Table A; (c) form and signature of Articles; (d) alteration of Articles?

15. Is there any limitation on the right of a company to alter its Articles? (*Royal Society Arts.*)

16. The prospectus of a company contained certain statements that were false. Can X, a shareholder in the company, set aside his share contract, and, if so, what must he prove?

17. What are the matters which must be stated in the prospectus? If a prospectus contains false statements, how far is a director liable to indemnify a person injured by them? (*Royal Society Arts.*)

18. What is the general liability of directors for statements made in a prospectus; and in what cases can they relieve themselves of such liability? (*Incorporated Accountants.*)

19. How does the law now stand as regards the disclosure of contracts in a prospectus? (*Chartered Accountants.*)

20. What particulars must the prospectus of a company now contain with respect to: (a) Shares and debentures previously issued; (b) Names of vendors; (c) Material contracts? Who is included under the term "vendor" for this purpose? (*Incorporated Accountants.*)

21. What do you understand by the term "Promoter"? What is his position as regards the company?

22. What are: (a) preliminary contracts, and (b) preliminary expenses in connection with a company? In what circumstances is a company liable in respect of these contracts and expenses?

23. Define Vendor in connection with a company. What are the details regarding Vendors that must appear in the prospectus?

24. The first directors of a company are usually named in the Articles: what must be done by the directors before such an appointment is valid?

25. How are Directors appointed? What is their position as regards the company? How are their duties and remuneration defined and fixed?

26. State what you know as to the use by a company of its Common Seal. When may a company have an Official Seal, and what is its purpose?

27. Distinguish between Underwriting Commission and Commission on placing Shares and define your duties as auditor with regard to each. (*Incorporated Accountants.*)

28. In what circumstances, and subject to what conditions, may commissions for underwriting be paid? (*Chartered Institute Secretaries.*)

29. The O.L.M. Co., Ltd., was formed with a capital of £100,000 in £1 shares, the whole amount being issued to the public. The underwriting was as follows: A, 35,000; B, 20,000; C, 30,000; D, 10,000; E, 2,000; F, 3,000.

All marked forms were to go in relief of the underwriters whose name they bear.

The applications on forms marked by the underwriters were: A, 10,000; B, 20,000; C, 22,500; D, 7,500; E, nil; F, 5,000.

Applications for 20,000 shares were received on forms not "marked."

Draw up a statement showing the number of shares each underwriter had to take up. (*Chartered Accountants.*)

30. What are the "powers and duties of auditors" under the Companies Act, 1948?

31. Can the directors of a limited liability company fix the remuneration of the auditors, or must the same be approved by the members in general meeting? Comment hereon.

32. If a person other than a retiring auditor to a limited company is nominated for the appointment, what formalities are necessary according to Section 159 of the Act of 1948?

33. What is meant by "Allotment of Shares"? When and how does an allottee become a member of the company? (*Royal Society Arts.*)

34. The Articles of Association of a company permit the directors to receive from shareholders payment in advance of their calls, allowing them interest on such advances. Is such interest necessarily dependent upon profits, and how should interest due and paid under such an arrangement be treated in the Profit and Loss Account? (*Chartered Accountants.*)

35. What are Share Warrants? What rights are conferred by statute on the bearers of such warrants? (*Chartered Accountants.*)

36. Explain the terms: (1) Nominal Capital; (2) Issued Capital; (3) Subscribed Capital; (4) Paid-up Capital; (5) Unpaid Calls. Illustrate your answer by showing how these items are stated in the balance sheet of a limited company. (*Chartered Institute Secretaries.*)

37. Explain the meaning, and contrast the advantages, of the following classes of Shares: Preference Shares; Cumulative Preference Shares; Ordinary Shares; Participating Ordinary Shares; Founders' Shares. (*Royal Society Arts.*)

38. Explain the following classes of shares: (1) Ordinary; (2) Cumulative Preference; (3) Deferred Ordinary; (4) Management; (5) Founders'. (*Chartered Institute Secretaries.*)

39. Define the following: (a) Ordinary Shares; (b) Ordinary Stock; (c) Cumulative Preference Shares; (d) Debentures.

40. What is a "Cumulative Preference Share"? The A B Company is three years in arrear with the dividends on its 1,000 6% Cumulative Preference Shares

of £1 each. Would this fact affect the annual accounts? If so, how? (*Royal Society Arts.*)

41. What is a Debenture? Give a draft of the principal terms and conditions which might be expected to be found contained therein.

42. What is usually the primary object, and what are the principal advantages of collaterally securing debentures by a trust deed? (*Chartered Accountants.*)

43. What is a Floating Charge? How far is it liable to be postponed to the rights of other creditors? (*Royal Society Arts.*)

44. In what circumstances may debentures be re-issued by a company after they have been paid off or purchased by the company? (*Chartered Accountants.*)

45. A company issues 8% Notes. How do these differ from 8% Debentures?

46. State the circumstances in which interest may be allowed on calls paid in advance, and give the entries necessary to record such interest in the books of a limited company. (*Royal Society Arts.*)

CHAPTER X

LIMITED COMPANIES—*Continued*

STATISTICAL RECORDS, ETC.

[*Note.*—All references are to the Companies Act, 1948, unless otherwise stated.]

BESIDES the ordinary double-entry records that are necessary for the preparation of true accounts of all income and expenditure, and of the assets and liabilities of a limited company, there are certain other books, registers, and records that a limited company is, by Statute, bound to keep, and still others which, by reason of their constitution and management, limited companies have found it convenient to keep. In addition, there are sundry documents, returns, notices, etc., which a limited company must, by Statute, file with the Registrar of Companies. Further, while the business which a particular company exists to carry on is transacted on behalf of the shareholders by the Directors, the control of a limited company vests in the general body of shareholders. The acts of the Directors, meeting as such, must, by Statute, be duly recorded in Minute Books, and the control of the shareholders over their business must be exercised in the manner prescribed by Statute. These matters are briefly dealt with in this chapter.

Statutory Books and Documents, other than Books of Account.—

(1) *Register of Members* containing the particulars set out in S. 110, and *Index* thereto, if the members exceed fifty and the Register is not Alphabetical (S. 111).

(2) A record consisting of copies of the *Annual Return*, which must appear in a separate part of the Register of Members, giving the particulars required by S. 124.

(3) *Minute Books* to record proceedings at General and Extraordinary Meetings of the Company, and at the meetings of Directors or Managers (S. 145).

(4) *Register of Directors and Secretaries* (S. 200).

(5) *Register of Charges* (S. 104).

(6) In addition to the register of mortgages, a copy of every instrument creating any mortgage or charge must be kept (S. 103).

Non-Statutory Books.—

(1) *Agenda Book.*—One of the secretary's duties is to draw up in orderly form the various items of business to be transacted at Directors' and Shareholders' meetings. These *agenda, i.e.* things to be done, are entered on the left-hand page of a book, the right-hand page of which s left blank for the chairman to enter his own remarks regarding any

particular item of business transacted. In many cases the agenda are typed on loose sheets which can be destroyed when the fair-copy minutes have been signed.

(2) *Call Book* (*see* p. 362).

(3) *Debenture Interest Book* (*see* p. 400).

(4) *Directors' Attendance Book.*—This, as the name implies, is a book in which each Director present at any particular meeting signs his name or initials as evidence of his presence at that meeting.

(5) *Dividend Book* (*see* p. 376).

(6) *Register of Allotment Sheets* (*see* p. 293).

(7) *Register of Allotment Returns* (*see* p. 294).

(8) *Register of Certifications and Balance Tickets* (*see* p. 340).

(9) *Register of Debenture Holders* (*see* p. 333).

(10) *Register of Debenture Stock Holders.*

(11) *Register of Powers of Attorney.*—In this register, brief particulars are recorded of the grantors and holders of these instruments and the dates on which they expire. Unless such instruments are registered with the company, acts purporting to be done under them will not be recognised. Companies usually charge a fee of 2*s.* 6*d.* for registering these documents.

(12) *Register of Probates* (*see* p. 334).

(13) *Register of Sealed Documents* (*see* p. 335).

(14) *Register of Share Certificates.*

(15) *Register of Stock* (where stock is issued or shares are converted into stock).

(16) *Register of Stockholders* (*see* p. 332).

(17) *Register of Transfers* (*see* p. 336).

(18) *Transfer Fee Cash Book* (*see* p. 337).

Summary of Documents to be Filed with the Registrar.—

(1) Memorandum of Association (S. 12).

(2) Articles of Association (SS. 6 and 12).

(3) Declaration as to Compliance with Regulations (S. 15 [2], and S. 109 [1] (*d*) or S. 109 [2] (*c*)).

(4) Statement of Nominal Capital.

(5) Annual return of Capital, Members, and Directors (SS. 124 and 127), with certificates from Private Companies (S. 128, and, in the case of an " Exempt Private Company " the further certificate required by S. 129 [1] (*b*)).

(6) Nature of Consolidation of Shares, or conversion of shares into stock, or reconversion of stock into shares, or subdivision of shares, or redemption of redeemable preference shares, or cancellation of shares (S. 62).

(7) Returns as to Increase of Capital or of Members (S. 63).

(8) Reduction of Capital (SS. 66 and 69).

(9) Notices of Situation of, or change of, Registered Office (S. 107), Situation, or change, of office where a Dominion Register, if any, is kept (S. 119).

(10) Statutory Report (S. 130).

(11) Copies of Special or Extraordinary Resolutions (S. 143).

(12) Copy of Register of Directors and Secretaries and notification of changes therein (S. 200).

(13) List of Directors, and Consent of Directors to act, and undertakings to take qualification shares or statutory declaration that the requisite shares are registered in the names of the Directors (S. 181).

(14) Prospectus (S. 41) or Statement in Lieu of Prospectus (S. 48).

(15) Actual contracts, or, if not in writing, Particulars of Contracts in respect of Shares issued otherwise than for Cash (S. 52).

(16) Returns of Allotments (S. 52).

(17) Particulars of Charges (SS. 95, 96 and 97).

(18) Memorandum of Satisfaction of Mortgage or charge and declaration verifying same (S. 100).

(19) Statement of Commission paid on issue of Shares (S. 53).

(20) Office Copy of Order of Court sanctioning compromises, arrangements, reorganisation of Capital, etc. (S. 206), or for facilitating reconstruction and amalgamation (S. 208).

(21) Printed copy of Memorandum where objects have been altered, with copy of order of Court (S. 5).

(22) Special statement in lieu of prospectus where private company ceases to be such (S. 30).

(23) Copy of Order of Court regarding variation of Shareholders' rights (S. 72).

(24) Notice of appointment of Receiver or Manager (S. 102).

(25) Notice of rectification of Register of Members on Order of Court (S. 116).

(26) Copies of Balance Sheet, Auditor's Report, etc. (S. 127).

(*Note.*—The documents required to be filed on winding-up are not included above.)

Register of Members.—Persons may become members of a company by: (*a*) Signing the Memorandum, (*b*) Applying for and being allotted shares, (*c*) Transfer of shares by an existing member. The shares of a deceased member vest in, and may be transferred by, his executor or administrator; the shares of a bankrupt vest in and may be transferred by the Trustee.

Every company must keep, in one or more books, a register of its members and enter therein the following particulars:—

(*a*) Names, addresses, and occupations of the members, and a statement of the shares held by each member, distinguishing each share by its number, and the amount paid or agreed to be considered as paid on the shares of each member, or the amount of stock held by each member.

(*b*) The date at which each person was entered in the register as a member.

(*c*) The date at which any person ceased to be a member.

There is no statutory form of register, but the form illustrated on p. 323 complies with modern usage. It combines the Members' Register with the Share Ledger. It is a convenience to keep separate registers for each class of share issued—Ordinary, Preference, etc. In the case of small companies, the Transfer Register is included in the Members' Register. The register must date from the registration of the company, but pending the preparation of the complete register the Application and Allotment Sheets may be regarded as fulfilling temporarily the requirements of the Statute. The register may be contained in as many separate books as may be necessary. If the number of members is at all substantial, certainly if it is more than fifty, it is most strongly recommended that the register should be in loose-leaf form and kept alphabetically: this saves the necessity of an index, speeds reference, facilitates the removal of dead matter, and also saves the necessity of compiling an index to accompany the Annual Return.

The date of entry should be the actual date on which the entry was made in the register (since a person is not a member until his name is entered in the register), or the date of transfer. The date of ceasing to be a member should be the date when the transfer was passed by the Directors.

With the exception of notifications received from the Public Trustee, no notice of any trust shall be entered on the register, or be receivable by the registrar in the case of companies registered in England (S. 117, and Public Trustee Act, 1906, S. 11).

Index of Members.—Every company having more than fifty members must, unless the register of members is in such a form as to constitute in itself an index, keep an index of the names of members (S. 111). The index may be in the form of a card index.

Inspection of Register.—The register must be kept *either* at the registered office of the company *or* at the office where the work of writing it up is done (whether that office belongs to the company itself or to some other person). The Act thus recognises the modern practice of having the work of writing up the register done by a professional registrar, who often undertakes the care of the registers of numerous companies, quite independent of each other. The register must be open for inspection for not less than two hours per day during business hours by members free of charge, and by the general public on payment of 1*s.* or such less sum as the company prescribes (S. 113). A company may, on giving due notice by advertisement, close its register for a total period not exceeding thirty days in the year (S. 115). Usually, registers are closed for fourteen days prior to the Annual General Meeting for the purpose of preparing the dividend and voting lists.

Companies whose objects comprise the transaction of business in a dominion may, if so authorised by the Articles, keep their Dominion Branch Registers in that Dominion, but duplicates of such registers must also be kept at the place where the company's principal register is kept.

Any person may demand a copy of the register, or of any part thereof, on payment of 6*d.* per 100 words, or fractional part thereof. Such a copy must be sent to the person demanding it within ten days after the demand is received by the company (S. 113 (2)).

Posting Share Register.—This is done from the Application and Allotment Sheets already described, and from the Call Book for the

COMBINED REGISTER OF MEMBERS AND SHARE LEDGER.

Name ....
Address ....
Description ....

Date of entry as a member ....
Date of ceasing to be a member ....

Dr.		Shares Acquired.						Dr.			Cash due on Shares.							
Date.	No. of Allotment or Transfer Deed.	No. of Shares Acquired.	Class of Share.	Distinctive Numbers of Shares.		Details.	Folio.	Total Amount of Holding.			Date of Calls.	Amount due per Share.			Class of Share.	Total Amount Payable on Shares.		
				From	To			£	s.	d.		£	s.	d.		£	s.	d.

Cash Paid on Shares.						Cr.	Shares Disposed of.									Cr.
Due Date.	How Paid.	When Paid.	C.B. Folio.	Amount.			Date.	No. of Transfer Deed.	Folio in Transfer Register.	No. of Shares Disposed of.	Class of Share.	Distinctive Numbers.		Total Value of Shares Disposed of.		
				£	s.	d.						From	To	£	s.	d.

Note.—A " Balance " Column is useful where transfers are numerous.
The " description " is no longer a statutory part of the register under the 1948 Act (S. 110) though it was under the Act of 1929 (S. 96).
The columns relating to distinctive numbers will, of course, be omitted if the company has taken advantage of the permission to dispense with them or has converted its shares into stock. In the latter case appropriate alterations to the headings will be required.

subsequent calls. From these sources, the names, addresses, occupations, number of shares with their distinctive numbers, of each shareholder are obtained, and also the amounts due on application, allotment, and calls. These amounts furnish the *debit* against each shareholder. The Cash Book (or Shareholders' Cash Book, or loose Application and Allotment Sheets, if the issue be a large one) gives details of the payments made by shareholders (application, allotment, first call, etc.) and the posting of these particulars completes the *credit* side of the Share Register. Shares subsequently sold and transferred will be posted from the Transfer Register, or Transfer Guard Book, to the relative accounts of the old and new shareholders. The accuracy of the Share Register can be tested at any time, seeing that the detail balances should tally with the amount of capital the company has called up *less* calls in arrear *plus* calls paid in advance.

Annual Return.—It has already been stated (*see* p. 300) that an initial return must be made of a company's subscribed capital, and of any increases thereof. In addition, every company having a share capital must, once in every year, forward a return called the Annual Return (S. 124). The particulars to be included in this return are specified in Part I of the Sixth Schedule, and the return is to be as nearly as possible in the form set out in Part II: this form is in six sections, as follows:—

1. Address of the Company's Registered Office.
2. Situation of Registers of Members and Debenture Holders.
3. Summary of Share Capital and Debentures (this part of the return is illustrated on p. 326).
4. Particulars in Indebtedness (this is the total amount of all mortgages and charges which are required to be registered).
5. List of Past and Present Members (for details see below).
6. Particulars of Directors and Secretaries (*see* p. 327).

In the case of a private company, the return must be accompanied by certificates, signed by a director and the secretary, stating that: (1) the company has not since the date of the last annual return issued any invitation to the public to subscribe for shares or debentures, and (2) that the excess of the number of members over fifty consists wholly of present employees or of past employees who became members while they were employees. In the case of an Exempt Private Company, the secretary and a director must certify that the conditions set out in S. 129 (2) have been complied with (see p. 269), and except in the case of an Exempt Private Company the return must be accompanied by copies of all accounts laid before the company during the period to which the return relates and the reports of the directors and the auditors. All these must be certified as being true copies.

The List of Past and Present Members need only be in its complete form in one year in every three (an innovation introduced by the 1948 Act). The complete form calls for a list of the names and addresses of all persons who, on the fourteenth day after the company's Annual General Meeting for the year, either were then members or had ceased to be members since the date of the last return (or in the case of the

Number of Company.............. [FORM NO. 6A.

THE COMPANIES ACT, 1948

FORM OF ANNUAL RETURN OF A COMPANY HAVING A SHARE CAPITAL.

A Companies
Registration
Fee Stamp
of 5s.
must be
impressed
here.

As required by Part IV of the Companies Act, 1948
(Section 124).

ANNUAL RETURN OF .... LIMITED, MADE UP TO THE .... DAY OF ...., 19... (BEING THE FOURTEENTH DAY AFTER THE DATE OF THE ANNUAL GENERAL MEETING FOR THE YEAR 19...).

SITUATION OF REGISTERED OFFICE.

The address of the Registered Office of the Company is..

....

....

SITUATION OF REGISTER OF MEMBERS.

The address of the place at which the Register of Members is kept (if other than the Registered Office of the Company) is ....

....

....

....

....

....

....

....

SITUATION OF REGISTER OF DEBENTURE-HOLDERS.

The address of the place in Great Britain, other than the Registered Office of the Company, at which is kept any Register of holders of Debentures of the Company or any duplicate of any such Register or part of any such Register which is kept outside Great Britain is ....

....

....

....

....

CERTIFICATES APPROPRIATE TO A PRIVATE COMPANY ONLY.

A. CERTIFICATE TO BE GIVEN BY A DIRECTOR AND THE SECRETARY OF EVERY PRIVATE COMPANY (whether an Exempt Private Company or not).* (*The Signatures of two separate persons are required.*)

We Certify that the Company has not since the date of †[the incorporation of the Company/the last Annual Return] issued any invitation to the public to subscribe for any Shares or Debentures of the Company.

Signed................................ *Signed*..............................

Director. *Secretary.*

† *In the case of the first Return strike out the second alternative. In the case of a second or subsequent Return strike out the first alternative.*

B. FURTHER CERTIFICATE TO BE GIVEN AS AFORESAID IF THE NUMBER OF MEMBERS OF THE COMPANY EXCEEDS FIFTY.

We Certify that the excess of the number of Members of the Company over fifty consists wholly of persons who, under Paragraph (*b*) of Sub-Section (1) of Section 28 of the Companies Act, 1948, are not to be included in reckoning the number of fifty.

Signed...,............................ *Signed*..............................

Director. *Secretary.*

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* If the Company is an EXEMPT PRIVATE COMPANY the additional Certificate (C) on page 5 must be completed.

Note.—A Banking Company, in order to avail itself of the benefit of Section 432 of The Companies Act, 1948, must add to this Return a statement of the names of the several places where it carries on business.

The Return must be signed, *at the end*, by a Director and the Secretary of the Company.

SUMMARY OF SHARE CAPITAL AND DEBENTURES.*

(A) NOMINAL SHARE CAPITAL £................

	Number.	*Class.*		
DIVIDED INTO	....	....	shares of £..................	each
	....	....	shares of £..................	each
	....	....	shares of £..................	each
	....	....	shares of £..................	each

(B) ISSUED SHARE CAPITAL AND DEBENTURES.*

NOTE: * The reference to "Debentures" relates to paragraphs 12 and 13 only.

	Number.	*Class.*
1. Number of shares of each class taken up to the date of this return (which number must agree with the total shown in the list as held by existing members).	....	.... shares .... shares .... shares
2. Number of shares of each class issued subject to payment wholly in cash.	....	.... shares .... shares .... shares .... shares
3. Number of shares of each class issued as fully paid up for a consideration other than cash.	....	.... shares .... shares .... shares .... shares
4. Number of shares of each class issued as partly paid up for a consideration other than cash and extent to which each such share is so paid up.	.... issued as paid up to the extent of £......... .... issued as paid up to the extent of £......... .... issued as paid up to the extent of £......... .... issued as paid up to the extent of £.........	.... shares per share .... shares per share .... shares per share .... shares per share
5. Number of shares (if any) of each class issued at a discount.	....	.... shares .... shares .... shares .... shares
6. Amount of discount on the issue of shares which has not been written off at the date of this return.	. . .	. £..............

		Number.	*Class.*
7. Amount called up on number of shares of each class.	£...... per share on £...... per share on £...... per share on £...... per share on	....	.... shares .... shares .... shares .... shares
8. *Total amount* of calls received, including payments on application and allotment and any sums received on shares forfeited.		. . .	. £..............

		Number.	*Class.*
9. *Total amount* (if any) agreed to be considered as paid on number of shares of each class issued as fully paid up for a consideration other than cash.	£.................. on	....	.... shares .... shares .... shares .... shares
10. *Total amount* (if any) agreed to be considered as paid on number of shares of each class issued as partly paid up for a consideration other than cash.	£.................. on	....	.... shares .... shares .... shares .... shares
11. *Total amount* of calls unpaid		. . .	. £..............
12. *Total amount* of the sums (if any) paid by way of commission in respect of any shares or debentures.		. . .	. £..............
13. *Total amount* of the sums (if any) allowed by way of discount in respect of any debentures since the date of the last return.		. . .	. £..............

	Number.	*Class.*
14. Total number of shares of each class forfeited	....	.... shares .... shares .... shares .... shares
15. *Total amount* paid (if any) on shares forfeited	. . .	. £..............
16. *Total amount* of shares for which share warrants to bearer are outstanding.	. .	. £..............
17. *Total amount* of share warrants to bearer issued and surrendered respectively since the date of the last return.	Issued . Surrendered .	. £.............. £..............
18. Number of shares comprised in each share warrant to bearer, specifying in the case of warrants of different kinds, particulars of each kind.	....	

PARTICULARS OF INDEBTEDNESS.

9. Total amount of indebtedness of the Company in respect of all mortgages and charges which are required (or, in the case of a Company registered in Scotland, which, if the Company had been registered in England, would be required) to be registered with the Registrar of Companies under The Companies Act, 1948, or which would have been required so to be registered if created after 1st July, 1908. £..............

PARTICULARS OF THE PERSONS WHO ARE DIRECTORS* OF THE COMPANY AT THE DATE OF THIS RETURN.

NAME. (In the case of an individual, present christian name or names and surname.† In the case of a Corporation, the corporate name).	Any former christian name or names and surname.‡	NATIONALITY.	USUAL RESIDENTIAL ADDRESS. (In the case of a Corporation, the registered or principal office.)	BUSINESS OCCUPATION AND PARTICULARS OF OTHER DIRECTORSHIPS.§	DATE OF BIRTH.‖

PARTICULARS OF THE PERSON WHO IS SECRETARY OF THE COMPANY AT THE DATE OF THIS RETURN.

NAME. (In the case of an individual, present christian name or names and surname.† In the case of a Corporation or a Scottish firm, the corporate or firm name.)	Any former christian name or names and surname.‡	USUAL RESIDENTIAL ADDRESS. (In the case of a Corporation or a Scottish firm, the registered or principal office).**

NOTES.

* "*Director*" includes any person who occupies the position of a director by whatsoever name called, and any person in accordance with whose directions or instructions the Directors of the Company are accustomed to act.

† "***Christian name***" includes a forename, and "***surname***," in the case of a peer or person usually known by a title different from his surname, means that title.

‡ "***Former christian name***" ***and*** "***former surname***" *do* not include -

(*a*) in the case of a peer or a person usually known by a British title different from his surname, the name by which he was known previous to the adoption of or succession to the title; or

(*b*) in the case of any person, a former christian name or surname where that name or surname was changed or disused before the person bearing the name attained the age of eighteen years or has been changed or disused for a period of not less than twenty years; or

(*c*) in the case of a married woman the name or surname by which she was known previous to the marriage.

§ *Directorships.* The names of all bodies corporate incorporated in Great Britain of which the Director is also a Director should be given, except bodies corporate of which the Company making the return is the wholly-owned subsidiary or bodies corporate which are the wholly-owned subsidiaries either of the Company, or of another Company of which the Company is the wholly-owned subsidiary. A body corporate is deemed to be the wholly-owned subsidiary of another, if it has no members except that other and that other's wholly owned subsidiaries and its or their nominees. If the space provided in the form is insufficient, particulars of other directorships should be listed on a separate statement attached to this form.

‖ *Dates of birth* need only be given in the case of a Company which is subject to Section 185 of The Companies Act, 1948, namely, a Company which is not a Private Company or which, being a Private Company, is the subsidiary of a body corporate incorporated in the United Kingdom which is neither a Private Company nor a Company registered under the law relating to companies for the time being in force in Northern Ireland and having provisions in its constitution which would, if it had been registered in Great Britain, entitle it to rank as a Private Company.

** Where all the partners in a firm are *joint secretaries* the name and principal office of the firm may be stated.

N.B.—If there is not sufficient space for all the necessary entries in the above columns attach a separate sheet.

CERTIFIED COPY OF ACCOUNTS.

Except where the Company is either an Exempt Private Company as defined by Section 129 (4) of The ompanies Act, 1948, which sends with this Return a Certificate in the form set out on page 5, or an ssurance Company which has complied with the provisions of Section 7 (4) of The Assurance Companies ct, 1909, there must be annexed to this Return a written copy, certified both by a Director and by the ecretary of the Company to be a true copy, of every Balance Sheet laid before the Company in General leeting during the period to which this Return relates (including every document required by law to be nnexed to the Balance Sheet) and a copy (certified as aforesaid) of the Report of the Auditors on, and f the Report of the Directors accompanying each such Balance Sheet. If any such Balance Sheet or ocument required by law to be annexed thereto is in a foreign language there must also be annexed to hat Balance Sheet a translation in English of the Balance Sheet or document certified in the prescribed nanner to be a correct translation. If any such Balance Sheet as aforesaid or document required by law o be annexed thereto did not comply with the requirements of the law as in force at the date of the audit vith respect to the form of Balance Sheets or documents aforesaid, as the case may be, there must be made uch additions to and corrections in the copy as would have been required to be made in the Balance Sheet r document in order to make it comply with the said requirements, and the fact that the copy has been o amended must be stated thereon.

Either Certificate " C " or Certificate " D " opposite should be signed.

C) Additional Certificate to be given in the case of an Exempt Private Company by the persons signing the Certificates on page 1.

We Certify that, to the best of our knowledge ind belief, the conditions mentioned in Sub-Section 2) of Section 129 of The Companies Act, 1948, are atisfied at the date of this Return and have been atisfied at all times since .... *

(Signed) ....*Director.*

(Signed) ....*Secretary.*

* Insert " 1st July, 1948 " (the date of the commencement of The Companies Act, 1948), or, if the Company was registered after that date, the date on which it was registered, or, if the proviso to Section 129 (1) has effect in relation to the Return, the time at which it was shown to the Board of Trade that the conditions mentioned in the Certificate were satisfied.

(D) *(The Signatures of two separate persons are required on Certificates (C) and (D).)*

We Certify that there is annexed hereto a true copy of every Balance Sheet laid before the Company in General Meeting during the period to which this Return relates (including every document required by law to be annexed to the Balance Sheet) and a true copy of the report of the Auditors on, and of the report of the Directors accompanying, each such Balance Sheet.

(Signed)....................................*Director.*

(Signed)....................................*Secretary.*

The Balance Sheet referred to above should be identified by writing thereon—" This is the copy referred to in the annexed Certificate (D) " and signed as above.

LIST OF PAST AND PRESENT MEMBERS.

Indicate whether a Full List of Members or of Changes only ……………

LIST of persons holding Shares or Stock in the Company on the fourteenth day after the Annual General Meeting for 19…, and of persons who have held Shares or Stock at any time therein since the date of the last Return, or, in the case of the first Return, of the incorporation of the Company.

NOTE (1).—If the Return for either of the two immediately preceding years has given as at the date of that Return the full particulars required as to past and present Members and the Shares and Stock held and transferred by them, *only* such of the particulars need be given as relate to persons ceasing to be or becoming Members since the date of the last Return and to Shares transferred since that date or to changes as compared with that date in the amount of Stock held by a Member.

NOTE (2). If the names in this List are not arranged in alphabetical order, an Index sufficient to enable the name of any person to be readily found must be annexed.

Folio in Register Ledger containing particulars.	NAMES.	ADDRESSES.	ACCOUNT OF SHARES.				REMARKS.
			* Number of Shares or amount of Stock held by existing Members at date of Return.†	‡ Particulars of Shares transferred since the date of the last Return, or, in the case of the first Return, of the incorporation of the Company, by (*a*) persons who are still Members, and (*b*) persons who have ceased to be Members.			
				Number.†	Date of registration of Transfer.		
					(*a*)	(*b*)	
…………	…………	…………	…………	…………	…………	…………	…………
…………	…………	…………	…………	…………	…………	…………	…………
…………	…………	…………	…………	…………	…………	…………	…………

(*Signed*) …………………… *Director.*
(*Signed*) …………………… *Secretary.*
(*The Signatures of two separate persons are required.*)

* The aggregate number of Shares or Stock held by each Member must be stated, *and the aggregates must be added up so as to agree with the number of Shares or amount of Stock stated in the Summary of Share Capital to have been taken up.* (The words in italics are applicable only when the full list of members is given.)

† When the Shares are of different classes these columns may be sub divided so that the number of each class held, or transferred, may be shown separately. Where any Shares have been converted into Stock the amount of the Stock held by each Member must be shown.

‡ The date of registration of each Transfer should be given as well as the Number of Shares transferred on each date. The particulars should be placed opposite the name of the Transferor, and *not* opposite that of the Transferee, but the name of the Transferee may be inserted in the "*Remarks*" column immediately opposite the particulars of each transfer.

first return), since the company's incorporation. The list must either be in alphabetical order or suitably indexed and must state:—

(1) as regards existing members, the number of shares held by each at the date of the return, and

(2) as regards both past and present members, the numbers of shares transferred since the date of the last return, specifying the dates of registration of all the transfers in question.

S. 124 (1) (c) provides, however, that if a full return (as above) has been made in either of the two immediately preceding years the list need include only persons who have either become or ceased to be members since the date of the last return and all changes in shareholdings since that date, *i.e.* any member whose holdings have remained unchanged during the year may be omitted and, as regards a person who was a member a year ago but who has parted with a part of his holding, only particulars of the shares transferred need be shown.

Transfers of shares since the last return are recorded against the name of the transferor only, not the transferee, though the name of the transferee may be desired to be noted in the " remarks " column. In the case of a " full " return, the column in which is entered the numbers of shares held at the date of the return must be added up and the total must agree with the total issued capital of that class. In the event of there being different classes of shares, either the columns may be subdivided as appropriate, a separate subdivision to each class of capital, or each class may be dealt with in a separate list. The information required by the Act, and the form in which it is presented, including the " full " list of members, is illustrated on pp. 325-329.

A copy of the return as filed is made at the end of the Register of Members, but in large companies a duplicate copy is usually made on the official Form 6A used for the return, and is then bound up with previous returns in book form.

No return need be filed after the statutory meeting.

Minute Books.—By S. 145 every company shall cause minutes of all proceedings of general meetings and of its directors or managers to be entered in books kept for that purpose. Any minutes made therein purporting to be signed by the chairman of the meeting, or by the chairman of the next succeeding meeting, shall be evidence of the proceedings. Until the contrary is proved, every meeting whereof minutes have been so made shall be deemed to have been duly held and convened, and all proceedings had thereat to have been duly had, and all appointments of directors, managers, or liquidators to be valid.

Eminent counsel have advised that the words " Books of the Company " to which, under S. 162, auditors have right of access, include the Minute Books and Letter Books.

The minute books of general meetings are open to the inspection of any member during business hours, subject to such reasonable restrictions as the company may by its articles or in general meeting impose, but so that no less than two hours in each day are allowed for inspection. Any member may obtain a copy at a charge not exceeding 6*d.* per hundred words (S. 146).

Register of Directors and Secretaries.—S. 144 of the 1929 Act required a company to keep a "Register of Directors" in which had to be recorded statutory particulars regarding the directors *and managers*. The corresponding provisions in the 1948 Act (S. 200) are somewhat different. There is no longer any requirement as to the inclusion of managers (that is to say, of course, managers who are not directors), and the company's secretary must now be included. The particulars required to be recorded are, as regards each director, his full name, usual residential address, nationality, business occupation, and particulars of any other directorships he holds; also, in the case of a company to which S. 185 applies (see p. 283), the date of his birth. Particulars of other directorships need not include directorships in a company of which the company in question is a wholly owned subsidiary or which is itself a wholly owned subsidiary of the company in question. As regards a secretary, the necessary particulars are his full name and usual residential address. A copy of the register must be sent to the Registrar within fourteen days of the appointment of the first directors, and on any change occurring (as regards directors or secretaries) the Registrar must be notified of the change within fourteen days.

Register of Charges.—By S. 95, every mortgage or charge created by a company: (*a*) for the purpose of securing a debenture issue; or (*b*) on uncalled share capital; or (*c*) by an instrument which, if executed by a private person, would require to be registered as a bill of sale; or (*d*) on any land or interest therein; or (*e*) on any book debts; or (*f*) being a floating charge on the undertaking or property of the company; or (*g*) a charge on unpaid calls; or (*h*) on a ship or any share in a ship; or (*i*) on goodwill, on a patent or licence under a patent, on a trademark, or on a copyright or a licence under a copyright, is void as a security against the liquidator or any creditor of the company unless the instrument (if any) and prescribed particulars of the mortgage or charge is delivered to the Registrar for registration within twenty-one days after the date of its creation. That is, in the event of liquidation, or against an execution creditor, the lenders under an unregistered mortgage or charge are merely unsecured creditors. But on failure to register, the moneys secured by such a mortgage or charge immediately become payable.

The Registrar must keep in the prescribed form a register for each company of such mortgages and charges, and enter therein the date of creation of every such mortgage or charge, the amount secured by it, short particulars of the property mortgaged or charged, and the names of the mortgagees or persons entitled to the charge (S. 98 [1]). This Register forms part of the company's file at Bush House, and anyone may inspect it on payment of 1*s*. (S. 98 [3]).

The Registrar must give a certificate of any mortgage or charge registered by him, and this certificate is conclusive evidence that the requirements of the Act as to registration have been complied with (S. 98 [2]).

By S. 104, every limited company must keep a register of mortgages and enter therein all mortgages and charges specifically affecting

REGISTER OF CHARGES.

Date of Mortgage or Charge.	No. of Mortgage or Charge.	Amount.			Description of Property Mortgaged or Charged.	Name and Address of Mortgagee or Person Entitled Thereto.	Rate of Interest per Annum.			Amount of Half-yearly Yearly Interest.			Date of Interest Becoming Due.	Remarks.
		£	s.	d.			£	s.	d.	£	s.	d.		

STOCK HOLDERS REGISTER.

Name of Stock Holder ....
Address ....

Description ....
Date of entry as a Member ....
Date of ceasing to be a Member ....

Stock Acquired.							Stock Transferred.							Remarks.
Date.	No. of Transfer.	Name of Transferor.	Folio.	Amount Acquired.			Date.	No. of Transfer.	Name of Transferee.	Folio.	Amount Transferred.			
				£	s.	d.					£	s.	d.	

STOCK REGISTER.

Holders.				Particulars of Shares Converted.							Particulars of Stock Created.					Remarks.
Name.	Address.	Description.	Share Ledger Folio.	Certificate Number.	No. of Shares.	Distinctive Numbers.		Amount.			Certificate Number.	Stock Register Folio.	Amount.			
						From	To									
								£	s.	d.			£	s.	d.	

DEBENTURE HOLDERS REGISTER.

Name: *Robert Radford.* Address: 162 *Sutton Road, Streetley.* Description: *Gentleman.*

Debentures Acquired.										Debentures Disposed of.								
Date.	No. of Allotment Letter or Transfer Deed.	Name of Transferor.	Ledger Folio.	No. of Bonds or Certificates.	Distinctive Numbers of Bonds.		Value.			Date.	No. of Transfer.	Name of Transferee.	No. of Bonds or Certificates.	Distinctive Numbers of Bonds.		Value.		
					From	To	£	s.	d.					From	To	£	s.	d.
19... Dec. 8	321	Dick, Geo.	32	5	5	9	250	0	0	19.. Jan. 2	581	Coe, John	2	5	6	100	0	0

property of the company and all floating charges, giving in each case similar particulars to those the Registrar is required, by S. 98 [1], to enter in his register. A form of this register is shown on p. 332.

This company's register, together with copies of instruments creating any mortgage or charge, must be kept open for inspection at all reasonable times by any creditor or member of the company without charge, and the register itself for the inspection of any other person at a fee not exceeding 1s. per inspection (S. 105).

It will be seen that the registration of mortgages or charges is a double one: registration both by the company and the Registrar. The object of registration is to ensure that the creditors of a company get due notice of the creation of all charges on the company's assets. When a charge is paid off, a *Memorandum of Satisfaction* in the prescribed form should be filed with the Registrar, who will duly note the fact (S. 84).

Register of Stockholders.—Where stock has been issued it is necessary to keep a register of the holders, and of the shares converted into stock (*see* p. 333).

Register of Probates.—This is a Register used to record brief details of probates and letters of administration, etc., respecting the estates of deceased shareholders. A fee of 2*s.* 6*d.* is usually charged by companies for registration.

Register of Debenture Holders.—Rather surprisingly, the Act does not make the keeping of this register compulsory, though it is the almost universal practice to do so. S. 86 provides that if a register is kept it must be kept either at the registered office or at "the office at which the work of making it up is done"; if a company registered in England keeps a register, that register must be in England, and similarly for Scotland. The Register contains particulars of the names and addresses of the debenture holders together with particulars of their holdings. If the debentures are not fully paid, the Register must contain accommodation for the cash transactions between the company and the holders. If kept, the Register is open to inspection by debenture holders and shareholders, and copies may be demanded on payment of the prescribed fee. Any debenture holder or shareholder may obtain a copy of any trust deed securing debentures on payment of the prescribed fee (S. 87). A form of this Register is shown on p. 333.

The Register of Debenture Holders is posted from the Debenture Application and Allotment Sheets, and from the Debenture Cash Book, or, in small issues, the Cash Book proper. Changes of ownership are recorded in, and posted from, the *Debenture Transfer Register* (*Transfer Guard Book*). This latter register is similar in principle to the Share Transfer Register and need not be illustrated here.

Register of Debenture Stockholders.—If debenture stock has been issued, a register identical in principle to the Stock Holders Register given on p. 332 must be kept. Columns are provided in this register for details of the debenture stock acquired, number of the certificate, stock transferred or redeemed, and for showing the balance of stock still held.

Register of Sealed Documents.—In this register are recorded brief details of all documents that have been sealed by the company (*see* p. 283).

Register of Transfers.—A Register of Transfers is not compulsory, except in the case of Parliamentary companies, but it is necessary that a proper record should be kept of all transfers accepted by the company. A form of Register is given on p. 336.

Separate registers should be kept for each class of share. In small companies provision is usually made for the Register of Transfers at the end of the Share Ledger.

It is, perhaps, more usual in these days to keep a *Transfer Guard Book*, in which the actual transfer deeds are pasted in numerical order. The numbers of the old and new certificates, the distinctive numbers of the shares, and the folios of the members are noted on the transfer, and the posting is then made direct from the deeds to the Share Register. Another modern practice is to file transfers in a loose-leaf binding case. Debenture transfers are dealt with on precisely similar lines to share transfers, and no further illustration need be given. Separate registers must be kept for each class of share or debenture.

Share and Stock Transfers.—All securities can be transferred on sale whether they be inscribed, registered, or bearer securities, although in the last-mentioned case ownership usually passes by mere delivery. Every member of a limited company has a statutory right to transfer his shares subject to any restrictions on transfer imposed by the Articles. In private companies there must be such restrictions. In the absence of power in the Articles, directors have no right to refuse to register transfers (*Weston's Case* [L.R. 4 Ch. 20]). Where discretionary power exists, Directors may decline to register transfers without giving any reason. But such powers must be exercised for the benefit of the company and not for individuals (*Bennett's Case* [1854]). The Stock Exchange will not grant a quotation to any company possessing power to refuse transfers.

In connection with transfers, Lindley, L.J., in *Taylor, Phillips & Rickard's Case* [1897], said: "The word share does not denote rights only—it denotes obligations also; and when a member transfers his share he transfers all his rights and obligations as a shareholder as from the date of transfer. He does not transfer his rights to dividends * or bonuses already declared, nor does he transfer liabilities in respect of calls already made; but he transfers his rights to future payments and his liabilities to future calls."

On the death of a shareholder, his shares automatically pass to his executor or administrator as personal estate. The estate is liable for uncalled liability, but the executor is under no personal liability unless

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* But shares transferred on the Stock Exchange after the dividend has been declared or paid but *before* such shares are, by the Stock Exchange Rules, quoted *ex div.*, transfer to the purchaser the right to the dividend, which must be paid over to him by the vendor.

Grant, Wood & Co., Ltd.

TRANSFER REGISTER.

Number of Transfer.	Date Transfer Lodged.	Date of Transfer Deed.	TRANSFEROR'S			Transferor's Folio in Share Register.	SHARES TRANSFERRED.					Distinctive Numbers.		TRANSFEREE'S			Transferee's Folio in Share Register.	Number of New Certificate.
			Name.	Address.	Occupation.		Number.	Amount per Share paid.	Capital paid up.			From	To	Name.	Address.	Occupation.		
									£	s.	d.							
121	19... Mar. 6	19... Mar. 5	*Jones,* Owen	Llantrysant	Farmer	69	2000	£1	2,000	0	0	72096	74095	*Norman,* Henry	1754 Cannon St., E.C.	Chartered Accountant	172	1046
207	April 9	April 8	*Norman,* Henry	1754 Cannon St., E.C.	Chartered Accountant	172	1500	£1	1,500	0	0	34001 72096	35000 72595	*Higgins,* Abel	Aberystwyth	Saddler	428	1362
212	April 15	April 8	*Norman,* Henry	1754 Cannon St., E.C.	Chartered Accountant	172	1500	£1	1,500	0	0	72596	74095	*Morris,* John James	Westmeath, Sleaford	Farmer	461	1382
														(*Signed*)	ISIDORE	GRANT, *Chairman.*		

he requests to be placed on the register *Buchan's Case* [1879]). For these reasons executors very rarely register,* as, in their representative capacity, they can execute transfers upon sale of the shares after registration of probate with the company. On the death of a joint holder, the shares vest in the survivor, and a death certificate will be accepted by the company as sufficient evidence. On bankruptcy, the debtor's shares are in the disposition of the trustee, who can transfer them on the same conditions as the bankrupt could have done, or he can disclaim any shares on which there is a liability for uncalled capital.

Form of Transfer.—A transfer must be in writing (S. 75). The particular form of transfer prescribed by the company's Articles must be used. Sometimes the form of transfer is set out in the Articles (Table A, clause 18, gives a form of transfer). In the great majority of cases, the common form of transfer given on p. 338 is accepted.

This common-form transfer can be obtained from any law stationer. Its use is compulsory if a Stock Exchange quotation is to be obtained. Companies will not accept transfers which deal with more than one class of share. Transfers sent for registration must be accompanied by the relative share certificates, and the transfer fee which, usually, is 2*s.* 6*d.* per deed. Transfer fees are posted to a "Transfer Fee Account" in the Ledger, and duly appear, in a single total, on the credit side of the Profit and Loss Account.

Transfer Fees Book.—In large companies, where dealings in the shares are numerous, a Transfer Fees Book, ruled as under, is kept to record the receipt of transfer fees. The totals from this book are entered at intervals in the General Cash Book. In some cases, the transfer work is handed over to an outside registrar, in which case the fees go to him in whole or part payment for his services. When that is so, no entries for transfer fees are made in the company's books.

TRANSFER FEES BOOK.

Date.	No. of Transfer.	Paid by	Amount.			Remarks.
			£	s.	d.	

Transfer Stamp Duties.—The rate of duty was increased by the Finance Act, 1947, and the scale now in force is as set out below:—

If the consideration is not more than £25, the duty is 2*s.* for each £5 or part of £5 of the consideration. Thus duty on £4 would be 2*s.*; on £19 it would be 8*s.*; and on £21, 10*s.*

If the consideration is more than £25 but not more than £300, the duty rises by steps of 10*s.* per £25 or part of £25 of consideration.

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* In some cases, the Articles empower the directors to compel representative holders to register the shares in their own or a nominee's name.

SHARE TRANSFER.

Impressed
Stamp
£20

Certificate of the within mentioned 2,000 *Shares* has been lodged at the Company's Office.
ROBERT WOOD,
Secretary.

I, Owen Jones, of Llantrysant, Farmer, in consideration of the sum of [See Note at Foot.] *Two thousand pounds* paid by *Henry Norman, of* 1754 *Cannon Street, E.C., in the City of London, Chartered Accountant,* hereinafter called the said Transferee,

Do hereby bargain, sell, assign and transfer to the said Transferee:—*Two thousand* (2,000) *fully paid shares of one pound each, numbered* 72096 to 74095 *inclusive,* of and in the undertaking called *Grant, Wood and Company, Limited.*

To hold unto the said Transferee, *his* Executors, Administrators and Assigns, subject to the several conditions on which *I* held the same immediately before the execution hereof; and *I* the said Transferee do hereby agree to accept and take the said *Shares* subject to the conditions aforesaid.

As Witness our Hands and Seals, this *fifth* day of *March*, in the Year of our Lord One thousand nine hundred and .

Signed, sealed, and delivered, by the above named *Owen Jones*, in the presence of

Witness's
Signature,* *Michael Macgillicuddy.*
Address, *Llantrysant, Wales.*
Occupation, *Farm Bailiff.*

OWEN JONES. SEAL

Signed, sealed, and delivered, by the above named *Henry Norman*, in the presence of

Witness's
Signature,* *N. Howell.*
Address, 1754 *Cannon Street, London, E.C.*
Occupation, *Audit Clerk.*

H. NORMAN. SEAL

Signed, sealed, and delivered, by the above named........................in the presence of

Witness's
Signature * ....
Address ....
Occupation ....

.... SEAL

Signed, sealed, and delivered, by the above named........................in the presence of

Witness's
Signature * ....
Address ....
Occupation ....

.... SEAL

NOTE.—The Consideration-money set forth in a transfer may differ from that which the first Seller will receive, owing to subsales by the original Buyer; the Stamp Act requires that in such cases the Consideration-money paid by the Sub-purchaser shall be the one inserted in the Deed, as regulating the *ad valorem* Duty; the following is the *Clause* in question:—

> "Where a Person having contracted for the purchase of any property, but not having obtained a Conveyance thereof, contracts to sell the same to any other Person, and the Property is, in consequence, conveyed immediately to the Sub-purchaser, the Conveyance is to be charged with *ad valorem* Duty in respect of the Consideration moving from the Sub-purchaser"—[54 & 55 Vic., cap. 39 (1891), section 58, sub-section 4].

INSTRUCTIONS FOR EXECUTING TRANSFERS.

* *When a transfer is executed out of Great Britain, it is recommended that the Signatures be attested by H. M. Consul or Vice-Consul, a Clergyman, Magistrate, Notary Public, or by some other person holding a public position—as most Companies refuse to recognise Signatures not so attested. When a witness is a Female she must state whether she is a Spinster, Wife or Widow and if a Wife she must give her Husband's Name, Address, and Quality, Profession, or Occupation. The Date must be inserted in Words and not in Figures.*

Thus duty on £26 would be £1: on £275 it would be £5 10s.: on £276, £6.

If the consideration exceeds £300, the duty rises by steps of £1 for each additional £50 or part of £50 of consideration. Thus duty on £301 would be £7; on £350, £7; on £351, £8, and so on without limit.

If however the transfer is made to a body of persons established for charitable purposes only, duty is assessed at the rates in force before the Finance Act, 1947, took effect, *i.e.* at half the above rates.

Over £300, the duty is £1 for every additional £50 or fraction thereof. Unless these duties are paid within thirty days of execution a penalty is incurred.

If a transfer operates as a gift, or in discharge of a debt, the statutory *ad valorem* duty is payable on a value to be agreed between the transferor and the Inland Revenue; and an "adjudication" stamp must be impressed, as otherwise the transfer is not duly stamped.

Nominal Consideration.—Where a transfer is not made on sale or gift, *e.g.* where an executor transfers shares to a legatee to whom they have been bequeathed, or a nominee transfers shares to the person for whom he holds them, it is usual to insert a nominal consideration of 10s., and a 10s. stamp only is required. Persons registering a transfer not duly stamped are liable to penalties, and such transfers will not be accepted in evidence in civil proceedings.

During and since the war there have been restrictions on the free transmission of shares and debentures, even in public companies, such restrictions being imposed to prevent the ownership of the shares passing into enemy hands, or (more recently) to ensure that the ownership remains with persons in the "sterling area." Such restrictions necessitate the completion of statutory declarations (by recognised stockbrokers, etc.) on behalf of both transferor and transferee, the forms of such declarations being usually printed on the back of the transfer; unless the forms are duly completed the transfer cannot be registered. Similar declarations have to be made whenever bearer bonds change hands, and a British bank will not accept the custody of any bonds unless the proper declaration accompanies them.

Liability of Parties to a Transfer.—The Articles usually empower the directors to refuse to register a transfer of shares upon which all calls have not been fully satisfied. If there are any unpaid calls on shares forming the subject-matter of a transfer, the transferor is liable until the transfer has actually been registered. Under S. 212, there is also a contingent liability after registration. If liquidation supervenes within one year of the registration, the transferor is liable for unpaid calls as a "B" *Contributory*, if the "A" *List of Contributories* has been exhausted, and the person to whom he transferred his shares fails to meet his liability for the unpaid calls, and debts of the company outstanding when the transferor ceased to be a member of the company still remain undischarged.

Scrutiny of Transfers.—All transfers before being passed are carefully checked as to date, stamp duty, signatures, witnesses, distinctive number of shares, etc. Alterations must be initialled by all parties. As a precaution against fraud, the transferor is usually notified of the lodgment of the transfer, and a record of such notifications is kept in a Notice of Transfers Lodged Book. If the Directors approve the transfer, a resolution to that effect is passed, and the transfer is recorded in the Transfer Register or filed in a Guard Book, initialled by the chairman, and duly posted to the Share Ledger. In due course a new certificate is sealed and forwarded to the transferee.

If a company refuses to register a transfer, it must, within two months after the date on which the transfer was lodged with the company, send to the transferee notice of the refusal (S. 78).

Balance Tickets.—When certificates are lodged embracing more shares than are necessary to satisfy a transfer, a Balance Ticket is issued to the transferor. Balance Tickets are issued free. They form temporary certificates, are accepted on the Stock Exchange, and enable the transferor to deal with the balance of his holding. In due course, they are exchanged, on payment of 1*s.* fee, for definitive certificates, the old certificates being cancelled. Particulars of such transactions are recorded in the Register of Certifications and Balance Tickets.

The usual form of Balance Ticket is as follows:—

Ravarys, Ltd.

London,
Spencer House,
South Place, E.C. 2.

.... 19...

Received from ....

....

Share Certificate No. .... in favour of ....

for .... shares in the above Company, deposited against a Transfer for .... shares.

Balance of shares remaining ....

(Signed) ....
Registrar.

N.B.—Transfer hours: 11.30 to 2.30, Saturdays excepted.

Blank Transfer.—A blank transfer is a transfer executed by the transferor only, no transferee being named, and no date inserted in the transfer. Such a transfer attached to the relative certificate is frequently deposited as equitable security for a loan—the intention being that the transferee shall, when the agreed event happens, fill in his name, or a purchaser's, and so complete the document. But it is no protection against a fraudulent transferor who, representing to the company that the certificate has been lost, obtains a fresh certificate and then sells the shares. To make the security complete it is well for the lender to serve upon the company a *Notice in Lieu of Distringas*. This ensures that, if any attempt is made by the transferor to transfer the shares elsewhere, the company must give to the mortgagee notice of the fact. The lender can at any time within eight days of the receipt of the notice apply to the Court for an order to prevent the transfer. Where a transfer must by the Articles be by deed, a blank transfer is useless, for as a deed it is void. In that case the borrower should execute a power of attorney, authorising the lender to execute a transfer in the borrower's name, to " sign, seal, and by his act and deed deliver " a transfer of the shares. The notice in lieu of distringas should also be given.

Certification.—The transferor, or his broker, may complete the transfer form so far as the transferor is concerned, and lodge it with the relative certificate at the company's office for " certification." After seeing that the certificate and transfer are *prima facie* in order, the secretary or registrar will then impress on the transfer, by means of a rubber stamp, a certificate that a share certificate covering the shares to be transferred has been lodged with the company.

Ravarys, Ltd.

A certificate of the within mentioned .... shares has been lodged at the Company's office.

(Signed) ....
Secretary.

The transfer form so certified is accepted by the transferee as sufficient evidence of title, since the company retains the share certificate.

In the case of quoted shares, certification may be done by the Secretary of the Stock Exchange.

Forged Transfers.—A transferee under a forged transfer obtains no rights over the subject-matter of the transfer. But if acting upon a forged transfer, a company issues to the transferee a certificate, then any person who acts on the faith of it and suffers damage is entitled to be compensated by the company (*Bloomenthal's Case* [1897]). The true owner of shares transferred upon a forged transfer is entitled to have his name restored to the Register as owner of the shares. It is not the registration of the transferee's name that gives the right to compensation, but the issue of the certificate, which is *prima-facie* evidence of title to the shares, and upon which a person is entitled to act. Many companies protect themselves against loss through forged transfers by taking out a Lloyd's policy of insurance, or it may build up a Fund, under the Forged Transfer Acts, for the purpose.

Debenture Transfers.—The transfer of debentures is subject to the same regulations, stamp duties, and registration fees as is the transfer of shares. A Debenture Transfer Register is kept to record such transfers, which are effected on principles identical with those already described. Debentures can be transferred only for the fixed sums they represent, *e.g.* £50, £100, etc. Debenture stock, on the other hand, can be transferred in any sum.

EXAMINATION QUESTION.

What is a mortgage? What records are necessary in the case of a limited company which has mortgaged its freehold property? (*Royal Society Arts.*)

Solution.

Definition.—A mortgage is a conditional transfer of property made by a borrower to secure the repayment of a sum of money at a fixed date, together, usually, with interest thereon. In other words, it is security given by a borrower of money to the lender to cover a loan.

Statistical Records.—A brief description of the property charged, the amount of the charge, and the names and addresses of the mortgagees must be entered in the Register of Mortgages kept at the registered office of the company, as required by S. 104. Similar particulars must also be sent to the Registrar of Companies within twenty-one days for registration in the company's file at Bush House (S. 96).

Financial Records.—The cash received from the lender must be debited, on receipt, in the Cash Book, and posted therefrom to the credit of the Mortgage Account. Notes should be made as part of the heading of the Account, recording the due date, the rate of interest payable, and the dates upon which it is payable. Notes should also be made as part of the Ledger headings of the asset accounts charged under the mortgage.

Company Meetings.—Distinctive names are given to the meetings which may, or must, be held by limited companies:—

Statutory Meeting.—This is provided for by S. 130. It is usually the first meeting held. Every limited company, other than a private company, must hold this meeting (unless limited by guarantee without a share capital) not less than one month or more than three months from the date when the company is authorised to commence business. Fourteen clear days before the meeting, a Statutory Report, in the prescribed form, must be sent to all members, and a copy be filed with the Registrar. This report and the procedure at the meeting are discussed in detail on p. 413. The object of the meeting is to afford shareholders an opportunity to discuss any matter arising out of the formation of the company, and the company's prospects.

Annual General Meeting.—Every company must hold at least one ordinary meeting in every calendar year (S. 131). This ordinary general meeting must be held, under penalty if it be not held, not more than fifteen months after the preceding ordinary general meeting. The statutory meeting is not an ordinary general meeting. At this meeting, the notice convening the meeting is read, the accounts are presented, and the Auditors' Report thereon is read. If the meeting approves the accounts they are passed, and the dividends (if any) proposed to be paid by the Directors are declared. Retiring Directors and Auditors are re-appointed or the vacancies otherwise filled. The regulations for calling and conducting these meetings are contained in the company's Articles. These meetings are termed *Ordinary Meetings*, and the business transacted thereat is *Ordinary Business*. The Articles usually specify the business that is to be considered ordinary business. Business outside this specification is deemed to be *Special Business*, and in order to transact special business particulars of its nature must be given in the notice convening the meeting. The length of notice required for meetings is governed by the Articles, but S. 133 provides that the notice must not in any event be less than twenty-one days in the case of the Annual General Meeting or fourteen days for other meetings (unless called for the passing of a special resolution (*see* p. 344). If the company's accounts are to be laid before the meeting a copy of the accounts and of the directors' and auditors' reports must accompany the notice (S. 158). Only shareholders, or their proxies (if the Articles so provide), are entitled to attend and vote. If default is made in calling this meeting, the Court may call it upon application of any member of the company. The majority of Articles provide that if the directors default in calling an annual general meeting two members may convene it. The auditors are entitled to attend all general meetings and to receive all notices relating thereto (S. 162).

Extraordinary General Meetings.—Meetings other than those described above are termed Extraordinary General Meetings. These may be called when desirable by the Directors, and must be called when requisitioned by the holders of not less than one-tenth of such of the paid-up capital of the company as at the date of the deposit of the requisition carries the right of voting at general meetings (S. 132). Where there are no special Articles to meet the case, two or more members holding not less than one-tenth of the issued share capital can convene a meeting (S. 134). The Articles usually provide that all business transacted at an extraordinary meeting is to be deemed *special*, that full particulars of the business to be transacted must appear in the notice convening the meeting, and that no other business than that mentioned shall be transacted at the meeting. Debenture holders are not entitled to attend these meetings, neither, as a general rule under the Articles, are Preference Shareholders.

Company Resolutions.—Company resolutions are of three kinds: (*a*) Ordinary resolutions, (*b*) Extraordinary resolutions, (*c*) Special resolutions.

(a) *Ordinary Resolutions.*—These are resolutions passed on a show of hands or a poll by simple majority of those present, voting personally or by proxy, if the Articles allow of proxies. Such resolutions suffice for the ordinary business of an annual meeting, *e.g.* the adoption of the Report and Accounts, and declaration of dividend, election of Auditors, etc., and, subject to the Articles, for alterations of capital under S. 61 (*see* p. 271).

(b) *Extraordinary Resolutions.*—These are passed by a majority of not less than three-fourths of such members as, being entitled so to do, vote in person or, where proxies are allowed, by proxy, at a general meeting of which notice specifying the intention to propose the resolution as an extraordinary resolution has been duly given (S. 141 [1]). These resolutions are used for winding-up an insolvent company voluntarily, to compromise with creditors in voluntary liquidation, and for other specified purposes.

(c) *Special Resolutions.*—These are passed by such a majority as is required for the passing of an extraordinary resolution at a general meeting of which not less than twenty-one days' notice, specifying the intention to propose the resolution as a special resolution, has been duly given. If all the members entitled to attend and vote at such a meeting so agree, however, a resolution may be proposed and passed as a special resolution at a meeting of which less than twenty-one days' notice has been given (S. 141 [2]). These resolutions are passed to alter the Articles; reduce paid-up capital (with consent of the Court); change the name of the company (with leave of the Board of Trade); wind-up by the Court, and for many other purposes.

(d) *Resolutions requiring Special Notice.*—These resolutions are of a new type, introduced for the first time by the 1948 Act (S. 142). They are resolutions of which notice is given by a member to the company under one of the sections of the Act specifically requiring such notice. Examples are: (*a*) a resolution under S. 160 to appoint an auditor other than the retiring auditor, and (*b*) a resolution under S. 184 to remove a director before the expiration of his term of office. For a resolution requiring special notice to be effective, notice must be given *by* the mover *to* the company at least twenty-eight days before the meeting at which the resolution is to be moved, and the company must then give its members the same notice of the resolution as is required for the meeting itself or (if that is impracticable) notice by advertisement or other manner allowed by the Articles. Provided the necessary notice has been given a simple majority is all that is necessary to carry the resolution itself at the meeting.

Printed copies of all extraordinary and special resolutions must be filed with the Registrar within fifteen days of the date when they were passed (S. 143).

A declaration by the chairman of the meeting that a resolution has been carried is conclusive, unless the decision is challenged and a poll demanded (S. 141 [3]).

Poll.—A poll is an appeal to the general body of shareholders on some specified matter or proposal.

The regulations concerning the demand for, and conduct of, a poll are usually set forth in the Articles. S. 137 provides that, irrespective of the Articles, a poll may be demanded by: (1) five members entitled to vote (irrespective of their individual voting powers), (2) members holding one-tenth of the voting rights of all members entitled to vote, or (3) members holding shares conferring voting rights on which has been paid up not less than one-tenth of the total sum paid up on all shares carrying voting rights. This provision is new, there being nothing corresponding in the 1929 Act. Table A of 1948, clause 58, allows a poll to be demanded either by the chairman, by three members present in person or by proxy, or by members having voting rights as in (2) and (3) above. If the Articles make no provision and Table A is excluded, it would appear that any shareholder may demand a poll. The chairman of the meeting at which a poll is demanded decides the date of the poll, and the manner of conducting it. Usually, sheets of foolscap are ruled with: (1) a column for the signature of members, and (2) and (3) columns "For" and "Against" the resolution. Members record their votes by inserting in one of these columns the number of shares they hold. These sheets are checked with the Register of Members, and the result of the voting is afterwards announced by the chairman.

Voting.—The Articles of Association almost invariably define the voting power attached to a company's shares. If there are no regulations as to voting, Table A, unless expressly excluded, applies to companies registered since its promulgation. In the event of Table A being excluded, and no provision appearing in the Articles, each member has one vote in respect of each share or each £10 of stock held by him (S. 134 [*e*]). Article 54 of revised Table A provides that every member shall have one vote on a show of hands, and on a poll one vote for every share held by him. The great majority of companies adopt similar regulations. Table A confers the right of a casting vote on the chairman of a meeting, but if Table A does not apply and the Articles are silent it would appear that no such right exists (*Nell* v. *Longbottom* [1894], 1 Q.B. 767).

Proxies.—A shareholder may appoint a person to represent him at meetings, and practically to act as his agent. The word "proxy" is commonly applied both to the person appointed and to the instrument by which he is appointed. The Articles usually contain regulations as to proxies. Table A provides two standard forms of proxy, one (clause 70) appointing a proxy to vote at a specified meeting but without giving any indication how the vote is to be used, the other (clause 71) appointing the proxy to vote either for or against (as indicated on the form) the resolution in question. S. 136 of the 1948 Act enacts some complete new provisions regarding proxies. Under the 1929 Act there was no statutory right to appoint a proxy at all, the matter being left entirely to the company's Articles. Under the 1948 Act, however, every member, regardless of the Articles, has a right to appoint a proxy, and (more revolutionary) such proxy need *not* be a member of the company: in the case of a private company the proxy may speak as well as vote. A further provision is that a company is bound, under penalty, to include with every notice calling a meeting a statement that a member entitled to attend and vote is entitled to appoint a proxy and that the proxy need not be a member. Usually, proxies must be deposited forty-eight hours before the meeting at which they are to be used is held. It is usual to name three persons in the proxy form, in case one or other of the persons named is unable to attend the meeting. Proxies must bear a 1*d*. stamp, if for use on one occasion only, but if the proxy is a *General Proxy* a 10s. stamp is required. Proxies must not be reckoned as part of a quorum.

Quorum.—A quorum is the minimum number of shareholders that must be present in order to constitute a meeting a valid meeting. The number fixed by most Articles is three, and this is also the quorum fixed by Table A, Art. 45 of 1929, Art. 53 of 1948, for a public company. For a private company the quorum is two (1948, Part II, Art. 4). If Table A is excluded, the quorum for a private company is two members, any other company three members, personally present (S. 134 [*c*]).

Inspection.—On the application of either two hundred members or members holding not less than one-tenth of the shares issued, the

Board of Trade may appoint inspectors to investigate and report upon the affairs of a company in such manner as the Board directs (S. 164). The Board must also carry out an investigation (S. 165 [a]) if the company itself by special resolution requires it or if the court so directs by order, and *may* carry out the investigation (S. 165 [b]) if the Board considers that the circumstances suggest fraud in any of the manners laid down by the section. S. 165 has no counterpart in the 1929 Act. Inspectors so appointed can examine the officers and agents of the company on oath. Refusal to yield up to the inspectors books, documents, or information may result in the same penalties as contempt of court (S. 167 [3]). If from the Report the Board considers that any person has been guilty of a criminal offence against the company, the Board must refer the matter to the Director of Public Prosecutions (S. 169). The powers of inspection referred to above are general and refer to " the affairs of the company ": they are re-enactments, with slight modifications, of provisions in the 1929 Act. S. 172 of the 1948 Act, however, gives an additional power of inspection on behalf of the Board of Trade, relating to the membership and control of the company, for the purpose of determining the persons who have the true interest in the success (or failure) of the company or who are able to control or influence the company's policy. An application for an investigation under this section must be made by not less than the number of members required to apply for an investigation under S. 164 (above). An inspector appointed under this section will enquire into such matters as the beneficial ownership of shares or debentures standing in the names of nominees and into any arrangements or understandings in connection with the same, even though they may not be legally binding. If the Board of Trade consider an investigation desirable, but think the appointment of an inspector unnecessary, they may, instead, call for the relevant information themselves, and penalties are imposed for refusal to answer enquiries or the giving of false information (S. 173). If, as a result of an investigation under SS. 172 and 173, the Board considers it desirable, they may (S. 174) impose restrictions on the shares or debentures in question: the restrictions are (1) the rendering void of any transfer, (2) the abolition of voting rights, and (3) the prevention of any payment by the company in respect of the shares or debentures (except in a liquidation). The restriction will remain in force so long as the Board directs, but there is a right of appeal to the court.

EXAMINATION QUESTIONS.

1. What particulars must the register of members of a company contain? What are the provisions of the Companies Act, 1948, with regard to: (*a*) inspection, (*b*) obtaining copies of the register?

2. The officials of limited companies are under obligation to file certain returns with the Registrar of Companies. Are any of these returns of a financial nature? If so, briefly describe them. (*Royal Society of Arts.*)

3. What statutory books are compulsory for use by a limited liability company? Give a short statement as to what is required to be entered in each book. (*Chartered Accountants.*)

4. What are the returns required under the Act to be filed at the office of the Registrar of Companies; and what other documents would you expect to find on the file? (*Chartered Accountants.*)

5. For what purposes are the following books kept, as applied to a limited company: (*a*) Allotment Book; (*b*) Register of Members; (*c*) Minute Book; (*d*) Register of Mortgages? (*Chartered Accountants.*)

6. Briefly describe the uses and contents of the under-mentioned registers as employed by limited companies.

State the occasions, if any, upon which the auditor is concerned with them: (*a*) Register of Probates; (*b*) Register of Charges; (*c*) Register of Balance Certificates; (*d*) Register of Sealed Documents.

7. Robert Coe, of Fairvale, Somerset, potato-grower, applied on January 1, 19..., for 1,000 shares in the Erratic Motor Omnibus Company, Ltd., issued at par, paying 2*s.* per share on application.

These 1,000 shares were allotted to him on January 3, 19..., numbered 180365 to 181364, and he duly paid the allotment instalment of 8*s.* per share on January 4.

On January 5 he bought a further 1,000 shares, 10*s.* paid, numbered 24062 to 25061 on the Stock Exchange at the price of 11*s.* per share, free of stamps and brokerage, the transfer for the same being lodged with the Company on January 5, and approved by the Board the same day.

On January 16 he paid the first call of 10*s.* a share on his 2,000 shares, thus making them fully paid.

On February 5 he sold the whole of his holding on the Stock Exchange at 18*s.* per share, free of stamps and brokerage, the transfer being lodged with the Company and approved by the Board on February 10.

Show a ruling of a Share Ledger and a Transfer Register for the Company, inserting in the latter the details of the foregoing transactions as far as they apply, and giving in the former R. Coe's account as a member of the Company. (*London Chamber Commerce.*)

8. On November 11, J. B. Clark, of Altwood Road, Bray, applied for 1,000 £1 6% Preference Shares in the Marne Mining Co., Ltd., and paid 2*s.* 6*d.* per share upon application. These shares were allotted to him by resolution of the Directors on November 16, and were numbered 5490 to 6489. On November 18 he forwarded a cheque to the Company's Bankers for the amount due on allotment, viz. 5*s.* per share. On December 18 he paid to the Company's Bankers the first and final call of 12*s.* 6*d.* per share. On December 24 he sold 500 shares (numbered 5490 to 5989) at 25*s.* per share to A. Chatenay, The Chestnuts, Dover, the transfer for which was duly approved by the Directors on December 31.

You are required to show the entries necessary to record these transactions in the statistical books of the Marne Mining Co., Ltd. (*Royal Society Arts.*)

9. State the various kinds of meetings of shareholders and the rules relating to each. (*Royal Society Arts.*)

10. What statutory obligations are imposed upon limited companies as regards the holding of General Meetings? What rights and remedies are given to shareholders in regard to the summoning of General Meetings? (*Chartered Accountants.*)

11. What provision is made by the Companies Act, 1948, with respect to the convening of Extraordinary General Meetings of a company on the requisition of shareholders?

12. How, and by whom, may a General Meeting of a limited company be called, and what voting powers will its members have, where the Articles of Association of the company contain no provisions dealing with these matters? (*Chartered Accountants.*)

13. What powers has the chairman of a company meeting to adjourn the meeting? Can he be compelled to adjourn a meeting? (*Royal Society Arts.*)

14. State briefly the distinctions between an "ordinary," "extraordinary," and "special" resolution of a company. For what different purposes is a special resolution required by statute? (*Chartered Accountants.*)

15. What is meant by the expression "Resolutions requiring special notice" as used in the Companies Act, 1948? By whom, and to whom, is such notice given, and what is the length of notice required? Mention two types of resolution which require such notice.

16. Has an auditor the right of access to the Board Minute Book of a Company to which he has been appointed auditor? What are the provisions, if any, of the Companies Act, 1948, in regard thereto?

17. Define a "special resolution," and give two instances where such a resolution would be necessary to authorise transactions you are asked to certify as auditor to a limited company. (*Chartered Accountants.*)

18. Distinguish between Ordinary and Extraordinary Meetings, referring especially to the business capable of being transacted at either. When can and must they be held? (*Chartered Institute Secretaries.*)

19. What is the Annual Return and of what does it consist? When must it be made, and wherein do the details required from a public differ from those required of a private company?

20. In what ways are shares transferred? What is a blank transfer, and how can a lender who has taken a blank transfer as security protect himself against a subsequent fraudulent attempt to transfer the shares covered by the blank transfer?

21. Discuss the relative positions of a person who has taken a transfer of shares under a forged transfer: (*a*) where the company, acting on the forged transfer, has issued a share certificate; (*b*) where it has not. What is the position of the true owner of the shares in either case?

22. What are Balance Tickets? Is any record made when these documents are issued?

23. Describe the process known as Certification of Transfers.

24. What is a Poll? What are the regulations governing the taking of Polls and how are they taken?

25. What are the voting powers of members of a company limited by shares? When does the Chairman of a company meeting have a casting vote? What is a Quorum?

26. Must a shareholder always vote in person at a company meeting? If not, in what other way may he record his vote? Give your answer in as full detail as you can. Describe in detail the posting of a Share Register.

27. What is a "Blank Transfer"? How can a loan creditor secure his position when holding a blank transfer?

28. The prospectus of the 5% War Loan, 1929–47, announced that applicants were entitled to have their holdings allotted in any of the following forms: (*a*) Inscribed as Stock; (*b*) Registered as Stock; (*c*) Bonds to Bearer. Explain the meaning of these terms of issue, and describe the relative advantages and disadvantages of the three classes of security. (*Royal Society Arts.*)

29. Prepare "Statutory Report" from the following figures:—*Receipts*: On allotment of 50,000 shares of £10 each, £137,000. Proceeds sale of old building material removed from freehold, £1,742. Advanced on mortgage, £47,000. Received in respect of allotment of Debenture Stock (75% of £100,000), £75,000. *Payments*: Purchase of freehold, £205,000. Paid builders on account, £12,600. Paid for Stock in Bond, £24,350. Paid salaries, £247. Office and petty expenses, £147. Preliminary expenses to date, £2,471. (*Chartered Accountants.*)

30. As the auditor of a limited company, you are asked to certify the Statutory Report. Upon attending at the company's office you are furnished with the under-mentioned particulars, which you are asked to assemble in the statutory form.

Submit the necessary statement in the form you would be prepared to certify, and append your certificate thereto.

The company was entitled to commence business on January 3, 19... The Nominal Capital is 100,000 Ordinary Shares of £1 each. The number of shares allotted is 72,865, of which: (*a*) 40,000 were issued as fully paid to the vendor;

(*b*) 10,000 were fully called and paid up; (*c*) of the balance of the issue, 10*s*. per share had been called and paid, except that the first call of 2*s*. 6*d*. per share on 200 shares remained unpaid.

£10,000 had been received in respect of a loan on mortgage of the company's works.

The payments were as follows: Vendor, balance of purchase price, £5,000; Preliminary Expenses, £1,250 (estimated in the prospectus at £1,000); Contractors on account of Freehold Factory, £6,850, less £750 allowed by them for old building material on site; Office Salaries, £722; Directors' Fees, £150; Incidental Expenses, £182. Date the report March 5, 19..., and fix a date for the statutory meeting. (*Chartered Accountants.*)

31. Criticise the following Balance Sheet attached to the Annual Return of a company submitted to you as auditor for signature, before being sent to Bush House. To what date should such statement be made up? When may it be dispensed with?

BALANCE SHEET, JUNE 30, 19...

		£		£
To Share Capital issued— 100,000 Shares of £1 each		100,000	By Lands, Buildings, Plant, Goodwill and Trade Marks	120,000
,, Debenture Stock		50,000	,, Debtor Balances	30,000
,, Credit Balances and Reserve Funds		25,000	,, Stock	14,000
,, Profit and Loss Account at June 30	£2,500		,, Cash at Bank and Sundry Investments	17,500
,, Profit for year	9,000			
	11,500			
Less Dividend paid	5,000			
		6,500		
		£181,500		£181,500

(*Chartered Accountants.*)

32. Rule a specimen page for a "Register of Transfers" for a limited company, and illustrate its working by an example. (*Chartered Institute Secretaries.*)

CHAPTER XI

LIMITED COMPANIES—*Continued*

COMPANY ACCOUNTANCY.

[*Note.*—All references are to the Companies Act, 1948, unless otherwise ated.]

pening Entries.—When the formalities incidental to the formation nd registration of a company have been completed, the first task waiting the company book-keeper will be to record the application)r, and allotment of, shares, and the subsequent calls. The record of share issue in its simplest possible form would be as follows:—

Illustration.—Dicksons, Ltd., offered 50,000 ordinary shares of £1 each for subscription at par, payable in full on application (January 1). The exact amount of the issue was subscribed, allotted, and duly paid.

JOURNAL.

			DR.			CR.		
		P.L.	£	s.	d.	£	s.	d.
19... ın. 1	Sundry Shareholders . . . . . Dr. To Ordinary Share Capital Account . . For 50,000 Ordinary Shares applied for and allotted this day.	2 3	50,000	0	0	 50,000	 0	 0

CASH BOOK.

(DEBIT SIDE ONLY.)

		P.L.	£	s.	d.
19... ın. 1	To Cash (Sundry Shareholders)	2	50,000	0	0

LEDGER. 2

SUNDRY SHAREHOLDERS.

DR.								CR.			
		J.	£	s.	d.			C.B.	£	s.	d.
19... an. 1	To Ordinary Share Capital . .	1	50,000	0	0	19... Jan. 1	By Cash . .	1	50,000	0	0

3 ORDINARY SHARE CAPITAL ACCOUNT. 3

Dr.　　　　　　　　　　　　　　　　　　　　　　　　Cr.

			£	s.	d.	19...		J.	£	s.	d.
						Jan. 1	By Sundry Shareholders . .	1	50,000	0	0

Opening entries of so simple a character as those above are, however, improbable. A set of actual figures is therefore given below in order to carry the illustration further.

Illustration.—Uprichards, Ltd. offered the following for public subscription on January 1, all at par.

100,000 Ordinary Shares of £1 each.
20,000 8% Preference Shares of £5 each.
1,000 5% Debentures of £100 each.

The Ordinary Shares were payable:—

5*s*. per share on application.
5*s*. per share on allotment.
5*s*. per share one month after allotment.
5*s*. per share two months after allotment.

The 8% Preference Shares were payable:—

20*s*. per share on application.
30*s*. per share on allotment.
50*s*. per share one month after allotment.

The Debentures were payable:—

£20 per debenture on application.
£30 per debenture on allotment.
£50 per debenture one month after allotment.

The subscription list was closed on January 1 with the following result:—

The whole of the Debentures and 18,000 Preference Shares were subscribed, and the Ordinary Shares were over-subscribed to the extent of 10,000 shares. The Directors went to allotment on January 5, and letters of allotment and regret were posted on the same day, together with cheques for the deposits paid on the over-subscribed Ordinary Shares. The instalments were all paid on the due dates.

[*Note.*—For solution, see pp. 352–356.]

OPENING ENTRIES.

JOURNAL.

I

9...		L.F.	Dr. £	s.	d.	Cr. £	s.	d.
n. 5	Application and Allotment Account* (Ordinary Shares) . . . . Dr.	4	50,000	0	0			
	To Ordinary Share Capital Account . . .	1				50,000	0	0
	Being 10s. per share (5s. on application and 5s. on allotment) on 100,000 Ordinary Shares of £1 each allotted as per resolution of Directors, dated January 5, 19...							
, 5	Application and Allotment Account (8% Preference Shares) . . . . Dr.	5	45,000	0	0			
	To Preference Share Capital Account . . .	2				45,000	0	0
	Being 50s. per share (20s. on application and 30s. on allotment) on 18,000 Preference Shares of £5 each allotted as per resolution of Directors, dated January 5, 19...							
, 5	Application and Allotment Account (5% Debentures) . . . . Dr.	6	50,000	0	0			
	To Debentures Account	3				50,000	0	0
	Being £50 per debenture (£20 on application and £30 on allotment) on 1,000 Debentures of £100 each allotted as per resolution of Directors, dated January 5, 19...							
b. 5	First Call Account (Ordinary Shares) . . Dr.	7	25,000	0	0			
	To Ordinary Share Capital Account . . .	1				25,000	0	0
	Being the first instalment of 5s. per share on 100,000 Ordinary Shares made pursuant to the conditions of issue.							
" 5	First Call Account (Preference Shares) . . Dr.	8	45,000	0	0			
	To Preference Share Capital Account . . .	2				45,000	0	0
	Being First and Final Call of 50s. per share on 18,000 Preference Shares made pursuant to the conditions of issue.							
" 5	Call Account (5% Debentures) . . . . Dr.	9	50,000	0	0			
	To Debentures Account	3				50,000	0	0
	Being the final instalment of £50 per debenture of £100 each pursuant to the conditions of issue.							
ar. 5	Final Call Account (Ordinary Shares) . . Dr.	7	25,000	0	0			
	To Ordinary Share Capital Account . . .	1				25,000	0	0
	Being the Final Call of 5s. per share on 100,000 Ordinary Shares of £1 each made pursuant to the conditions of issue.							

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* Separate "Application" and "Allotment" Accounts are sometimes opened, but the combined ccount is more usual.

Note.—It has been stated in some text-books that these Journal entries are ometimes dispensed with, and the various capital accounts opened by direct osting from the Cash Book. The author has never seen or heard of such a ractice, and the student will be wise to employ Journal entries as set out above.

CASH BOOK.

1 Dr. | Cr. 1

Date		L.F.	£	s.	d.	Date		L.F.	£	s.	d.
19... Jan. 1	To Sundry Persons. Amounts received on application, being 5s. per share on 110,000 Ordinary Shares applied for . .	4	27,500	0	0	19... Jan. 5	By Sundry Persons. Amounts returned with letters of regret, being 5s. per share on 10,000 Ordinary Shares not allotted .	4	2,500	0	0
,, 1	,, Sundry Persons. Amounts received on application, being 20s. per share on 18,000 Preference Shares applied for .	5	18,000	0	0						
,, 1	,, Sundry Persons. Amounts received on application, being £20 per debenture on 1,000 Debentures applied for . .	6	20,000	0	0						
,, 5	,, Sundry Persons. Amounts received on allotment, being 5s. per share on 100,000 Ordinary Shares allotted . . .	4	25,000	0	0		*Note.*—In practice, the names, addresses, and other particulars relating to the various totals shown in this example would be set out in detail. A separate column would be kept for each class of share, or debenture, offered for subscription. If the issue were a large one, a separate Cash Book or loose Application and Allotment Sheets would be kept, and the totals only of the various columns would be carried to the Company's main Cash Book. This practice economises space and enables each instalment to be balanced with expedition. Usually debentures are payable in full on allotment.				
,, 5	,, Sundry Persons. Amounts received on allotment, being 30s. per share on 18,000 Preference Shares allotted . . .	5	27,000	0	0						
,, 5	,, Sundry Persons. Amounts received on allotment, being £30 per debenture on 1,000 Debentures allotted . . .	6	30,000	0	0						
Feb. 5	,, Sundry Persons. Amounts received in respect of First Call of 5s. per share on 100,000 Ordinary Shares . . .	7	25,000	0	0						
,, 5	,, Sundry Persons. Amounts received in respect of First and Final Call of 50s. per share on 18,000 Preference Shares .	8	45,000	0	0						
,, 5	,, Sundry Persons. Amounts received in respect of Final Call of £50 per debenture on 1,000 Debentures . . .	9	50,000	0	0						
Mar. 5	,, Sundry Persons. Amounts received in respect of Final Call of 5s. per share on 100,000 Ordinary Shares . . .	7	25,000	0	0						

LEDGER.

ORDINARY SHARE CAPITAL ACCOUNT.

1 Dr. — Cr. 1

			£	s.	d.	19...		J.	£	s.	d.
						Jan. 5	By Application and Allotment Account	1	50,000	0	0
						Feb. 5	" First Call Account	1	25,000	0	0
						Mar. 5	" Final Call Account	1	25,000	0	0
									£100,000	0	0

8% PREFERENCE SHARE CAPITAL ACCOUNT.

2 Dr. — Cr. 2

			£	s.	d.	19...		J.	£	s.	d.
						Jan. 5	By Application and Allotment Account	1	45,000	0	0
						Feb. 5	" First and Final Call Account	1	45,000	0	0
									£90,000	0	0

5% DEBENTURES ACCOUNT.

3 Dr. — Cr. 3

			£	s.	d.	19...		J.	£	s.	d.
						Jan. 5	By Application and Allotment Account	1	50,000	0	0
						Feb. 5	" Call Account	1	50,000	0	0
									£100,000	0	0

APPLICATION AND ALLOTMENT ACCOUNT (ORDINARY SHARES).

4 Dr. — Cr. 4

19...		C.B.	£	s.	d.	19...		C.B.	£	s.	d.
Jan. 5	To Ordinary Share Capital Account	1	50,000	0	0	Jan. 1	By Cash— Sundry Persons on Application	1	27,500	0	0
" 5	" Cash— Sundry Persons (application money returned)	J. 1	2,500	0	0	" 5	" Cash— Sundry Persons on Allotment	1	25,000	0	0
			£52,500	0	0				£52,500	0	0

LEDGER—*continued.*

APPLICATION AND ALLOTMENT ACCOUNT (8% PREFERENCE SHARES).

5 Dr. | Cr. 5

19...		J.	£	s.	d.	19...		C.B.	£	s.	d.
Jan. 5	Preference Share Capital Account . .	1	45,000	0	0	Jan. 1	By Cash— Sundry Persons on Application . .	1	18,000	0	0
						" 5	" Cash— Sundry Persons on Allotment . .	1	27,000	0	0
			£45,000	0	0				£45,000	0	0

APPLICATION AND ALLOTMENT ACCOUNT (5% DEBENTURES).

6 Dr. | Cr. 6

19...		J.	£	s.	d.	19...		C.B.	£	s.	d.
Jan. 5	To Debentures Account	1	50,000	0	0	Jan. 1	By Cash— Sundry Persons on Application . .	1	20,000	0	0
						" 5	" Cash— Sundry Persons on Allotment . .	1	30,000	0	0
			£50,000	0	0				£50,000	0	0

CALL ACCOUNT (ORDINARY SHARES).

7 Dr. | Cr. 7

19...		J.	£	s.	d.	19...		C.B.	£	s.	d.
Feb. 5	To Ordinary Share Capital Account (First Call)	1	25,000	0	0	Feb. 5	By Cash— Sundry Persons (First Call) . .	1	25,000	0	0
Mar. 5	" Ordinary Share Capital Account (Final Call)	1	25,000	0	0	Mar. 5	" Cash— Sundry Persons (Final Call) . .	2	25,000	0	0
			£50,000	0	0				£50,000	0	0

CALL ACCOUNT (8% PREFERENCE SHARES).

8 Dr. | Cr. 8

19...		J.	£	s.	d.	19...		C.B.	£	s.	d.
Feb. 5	To Preference Share Capital Account (First and Final Call)	1	45,000	0	0	Feb. 5	By Cash— Sundry Persons (First and Final Call).	2	45,000	0	0
			£45,000	0	0				£45,000	0	0

LEDGER—*continued.*

Call Account (5% Debentures).

9 Dr. — Cr. 9

		J.	£	s.	d.			C.B.	£	s.	d.
19... Feb. 5	To Debentures Account (Final Call) . .	1	50,000	0	0	19... Feb. 5	By Cash— Sundry Persons (Final Call) . .	2	50,000	0	0
			£50,000	0	0				£50,000	0	0

Note.—In cases where more shares are applied for by an applicant than are allotted to him, the surplus application moneys are usually retained and applied in reduction of the amounts due on allotment. Letters of Regret are usually sent only to those applicants who receive no allotment. If separate Application and Allotment Accounts are opened, the above practice involves a transfer of the surplus so retained as follows:—

	£ s. d.	£ s. d.
Application Account (Ordinary Shares) Dr.	2,500 0 0	
To Allotment Account (Ordinary Shares)		2,500 0 0
Being transfer of application moneys, 5s. per share on 10,000 shares over-subscribed and now applied in payment (or part payment) of allotment moneys.		

BALANCE SHEET, MARCH 5, 19...

	£	s.	d.	£	s.	d.		£	s.	d.
Capital :—										
Nominal—										
100,000 Ordinary Shares of £1 each .	100,000	0	0							
20,000 8% Preference Shares of £5 each.	100,000	0	0				**Note.—The compensating "Asset" side entry may be "Cash at Bank" or in the form of property purchased, or taken over, from a vendor on the formation of the Company.**			
	£200,000	0	0							
Issued—										
100,000 Ordinary Shares of £1 each, fully paid	£100,000	0	0							
18,000 8% Preference Shares of £5 each, fully paid	90,000	0	0	190,000	0	0				
5% Debentures :—										
1,000 Debentures of £100 each, fully paid				100,000	0	0				

Issue of Shares at a Premium.—A limited company may issue *debentures* at par, *i.e.* at their exact nominal value, *e.g.* £100 per £100 debenture; or at a discount, *e.g.* £98 per £100 debenture; or at a premium, *e.g.* £102 per £100 debenture. But a limited company cannot legally issue its *shares* at a discount, *i.e.* for less than their nominal or face value (*Ooregum Gold Mining Co.* v. *Roper*, [1892]), except under S. 57 (see p. 306), neither can it purchase its own shares (*Trevor* v. *Whitworth*, [1888]). It may, however, issue shares at any premium which their popularity with the investing public can command. Thus, *e.g.* the unissued £1 shares of a company paying high dividends may be offered to the public at, say, 22*s.* 6*d.* or 25*s.*, or more, per £1 share. The amount realised above the par value of the share is termed the *premium*.

Theoretically, the premium at which the shares are quoted represents the estimate made by the money market on the issuing company's ability to earn high profits in the future. This estimate is based partly on the amount of undistributed profits held by the company, and partly on the value of its goodwill. But there is always the possibility that, to an extent, the premium may be artificial owing to market operations.

When a company is so successful that it can command a premium on a new issue of shares, the purchasers of the new shares do, in fact, pay for admission to a share in the company's goodwill, as represented by its capacity to earn profits in excess of the normal rate. The new shareholders are very much in the position of an incoming partner who pays a premium for admission to an established business.

Usually, when a company's issued shares are quoted at a premium and it proceeds to a new issue of shares, the new capital is offered *pro rata* to the existing shareholders in priority to the general public. The Application and Allotment Sheets already described and illustrated (see p. 293) will serve equally well for an issue of shares at a premium, if a column is added to accommodate the amount of the premium due on each allotment. The Share Register needs no alteration, since no record of the premium paid on the shares is necessary, that Register being concerned only with the number and par value of the shares held by each member.

The premiums received on a share issue must be transferred to a "Share Premium Account" (S. 56), and the balance of this account must appear separately in the company's Balance Sheet (Eighth Schedule, Part I, para. 2 [*c*]). It is a capital reserve, and if there are any other capital reserves it will be one of the items set out under that heading. It cannot be transferred to General Reserve, or any other Revenue Reserve, and can be used (if used at all) only for one of the purposes set out in S. 56, viz.: (1) paying up unissued shares as fully paid bonus shares, (2) writing off preliminary expenses or commission or discount on the issue of shares or debentures, or (3) providing for the premium payable on the redemption of redeemable Preference Shares or debentures.

The entries required for an issue of shares at a premium are set out in the following illustration.

Illustration.—The nominal capital of Uprichards, Ltd., consisted of 200,000 ordinary shares of £1 each, of which 100,000 shares had been issued at par and fully paid up. Proving very successful, and needing additional working capital, the Company offered for public subscription on January 1 50,000 ordinary shares of £1 each (being part of their unissued nominal capital) at the price of 30s. per share, payable as to 5s. per share on application, 20s. per share on allotment (including the premium of 10s. per share), and 5s. per share one month after allotment. The whole of the new issue was subscribed, and the Directors proceeded to allotment on January 6. All allotment moneys were paid on January 8, and all calls on February 6.

ISSUE OF SHARES AT A PREMIUM.

1 JOURNAL.

			Dr.			Cr.		
19...			£	s.	d.	£	s.	d.
Jan. 6	Applications and Allotment Account . . Dr.	3	62,500	0	0			
	To Ordinary Share Capital Account . . .	2				37,500	0	0
	,, Share Premium Account	5				25,000	0	0
	Being 5s. per share on application, and 20s. per share on allotment, including the premium of 10s. per share on 50,000 Ordinary Shares allotted as per resolution of Directors, dated January 6, 19...							
Feb. 6	Call Account . . . . Dr.	4	12,500	0	0			
	To Ordinary Share Capital Account . . .	2				12,500	0	0
	Being 5s. per share on 50,000 Ordinary Shares of £1 each in respect of the First and Final instalments made as per conditions of issue and resolution of Directors, dated February 6, 19...							

(Continued on p. 359.)

Issue of Shares at a Discount.—It is illegal to issue shares at a discount within one year after the company becomes entitled to commence business, but at any time thereafter, a general meeting may resolve that further shares of a class already issued shall be issued at a discount. The resolution must state the maximum discount and must be sanctioned by the court before being put into operation. The court may impose conditions, and the shares must be issued within one month after the court has given its sanction, unless the court allows a longer period (S. 57).

The powers thus given by the Act may be useful where a company requires further capital at a time when its shares are quoted below par, since the existing members or new subscribers naturally would not be willing to pay par for new shares under such circumstances, but might be willing to subscribe at the market price, or at a price slightly below market price.

The entries for the issue of such shares are similar to those for the issue of any other shares, until the last call is made. It is submitted that the discount should not be credited to the members except that an entry must be made debiting Discount on Shares Account and crediting Share Capital. It is submitted that this entry should be made preferably at the date of allotment so that a Balance Sheet drawn up after this date, but before further calls are made, would show as an asset so much of the discount as had not been written off.

The Journal Entry would be:—

	£	£
Discount on Shares Account . . . . Dr.	500	
To Share Capital Account		500
Discount of 5% on issue of 10,000 shares of £1 each		

LEDGER.

ORDINARY SHARE CAPITAL ACCOUNT (ORIGINAL ISSUE).

1

Dr. | Cr. 1

			£	s.	d.				£	s.	d.
						19... Jan. 1	By Balance	J. 1	100,000	0	0

ORDINARY SHARE CAPITAL ACCOUNT (NEW ISSUE).

2

Dr. | Cr. 2

			£	s.	d.				£	s.	d.
						19... Jan. 6	By Application and Allotment Account .	J. 1	37,500	0	0
						Feb. 6	„ Call Account (First and Final Call) .	1	12,500	0	0
									£50,000	0	0

APPLICATION AND ALLOTMENT ACCOUNT (ORDINARY SHARES NEW ISSUE).

Dr. | Cr. 3

		J.	£	s.	d.			C.B.	£	s.	d.
19... an. 6	To Ordinary Share Capital Account . .	1	37,500	0	0	19... Jan. 1	By Cash, Application Account . .	1	12,500	0	0
„ 6	„ Share Premium Account	1	25,000	0	0	„ 8	„ Cash, Allotment Account and Premium .	1	50,000	0	0
			£62,500	0	0				£62,500	0	0

CALL ACCOUNT (NEW ISSUE).

Dr. | Cr. 4

		J.	£	s.	d.			C.B.	£	s.	d.
19... b. 6	To Ordinary Share Capital Account . .	1	12,500	0	0	19... Feb. 6	By Cash (First and Final Call) . . .	1	12,500	0	0

SHARE PREMIUM ACCOUNT.

Dr. | Cr. 5

			£	s.	d.			J.	£	s.	d.
						19... Jan. 6	By Application and Allotment Account .	1	25,000	0	0

CASH BOOK.

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Jan. 1	To Sundry Persons. Amounts received on application, being 5*s.* per share on 50,000 Ordinary Shares applied for .	3	12,500	0	0						
" 8	" Sundry Persons. Amounts received on allotment, being 20*s.* per share (10*s.* on allotment and 10*s.* premium) on 50,000 Ordinary Shares allotted	3	50,000	0	0						
Feb. 6	" Sundry Persons. Amounts received in respect of First and Final Call of 5*s.* per share on 50,000 Ordinary Shares . .	4	12,500	0	0						

BALANCE SHEET, FEBRUARY 6, 19...

(Debit Side Only).

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Capital :—													
Nominal—													
200,000 Ordinary Shares of £1 each . .	200,000	0	0										
Issued—													
100,000 Ordinary Shares of £1 each fully paid	100,000	0	0										
50,000 Ordinary Shares of £1 each (new issue) fully paid	50,000	0	0	150,000	0	0							
Share Premium Account				25,000	0	0							

Calls.—Almost invariably the Prospectus specifies the dates on which calls become due. An interval of at least one month is usual between calls, but if a Stock Exchange quotation is desired for shares, two months must elapse between calls. Table A requires one month only. If calls are not regulated by the conditions of issue, the Directors can make calls at their discretion, but subject, of course, to any provisions contained in the company's Articles. The Directors must pass a resolution stating the amount of the call and its due date. In the event of liquidation, the Liquidator can (with the sanction of the Committee of Inspection, or of the Court) make a call immediately he is appointed. Sanction is not required in either a members' or a creditors' voluntary liquidation. A form of call notice is given on p. 297.

Calls are usually made payable direct to the company's bankers, and, in large issues, separate cash books and banking accounts are opened for each call. Differently coloured paper is used for each class of share. In due course, the call notices are collected from the bank and checked with the relative cash book and bank pass book or sheets. When the call is complete, the total of the call banking account is transferred to the company's main banking account. This practice facilitates checking, relieves the main cash book from a mass of detail, and provides a convenient medium for posting the Share Ledger. Specimen ruling for, and *pro-forma* entries in, a Subsidiary Cash Book are shown on p. 362.

Sometimes Call Books are kept, separate books being employed for each class of share. No Call Book is necessary for debentures, as these are almost invariably payable in full on allotment. Columns for calls are sometimes provided on the Application and Allotment Sheets, particularly where the due dates for instalments are stated in the prospectus. A suitable ruling for a Call Book is shown on p. 298.

Interest on Calls in Advance.—Shares in limited companies that are not fully paid are unpopular with the investing public—except, perhaps, banking shares. Usually, therefore, the full nominal amount of an issue of ordinary or preference shares is called up within two or three months of allotment. Where for any reason a proportion of the issued share capital remains uncalled, provision will be found in the majority of Articles, under power conferred by S. 59 (*a*), to receive payment of calls in advance at a fixed rate of interest. The rates of interest payable, and the conditions under which they may be paid, have already been discussed on p. 298. The student must understand that calls paid in advance are in fact loans at interest to the company, the interest being payable although no profits are made by the company; nevertheless, they are not repayable unless the Articles so provide (*Lock* v. *Queensland Investment and Land Mortgage Co.*, [1896]). Table A makes no such provision. Separate Calls in Advance Accounts must be opened in the Ledger, and when a call is actually made, the Calls In Advance Account applicable to that particular call is closed by a transfer to Share Capital Account or Call Account as shown below. No entries are made in the Share Ledger until the call is due.

ayon d'Or, Ltd.

CALL BOOK.

Second and Final Call of 5*s.* per share on *100,000 Ordinary* Shares of £1 each.
Date Call made *July* 4, 19..., payable on or before *July* 18, 19...

No. of Call Letter.	Share Ledger Folio.	Shareholder.			No. of Shares Held.	Amount of Call Due at 5s.			Paid.					Outstanding.							Remarks.
		Name.	Address.	Description.					C.B. Folio.	Date.	Amount.			Amount.			No. of Days.	Interest Due.			
						£	s.	d.		19...	£	s.	d.	£	s.	d.		£	s.	d.	
240	1/47	Ross, Robert	41 Greek St., Soho, W.	Merchant	400	100	0	0	321	Jan. 2	100	0	0								*Note.* In this column will be noted any instructions received to apply to Bankers, or powers of attorney, etc., for further calls.
241	1/48	Chalmers, George	Maidenhead, Berks	Captain, D.S.O.	200	50	0	0	320	" 1	50	0	0								
242	1/49	Cross, Mary	Park St., Southend	Miss	100	25	0	0	321	" 2	25	0	0								
243	1/50	Ravary, Ann	16 Gloucester Terrace, W.	Mrs.	200	50	0	0	321	" 2	50	0	0								

SUBSIDIARY CASH BOOK.

(CALLS).

FIRST CALL 250,000 ORDINARY SHARES OF £1 EACH.

Date.	Name.	Address.	Call Book Folio.	Share Register Folio.	Amount.			Total Transferred to General Cash Book.			Cash Book Folio.	Remarks.
19...					£	s.	d.	£	s.	d.		
Jan. 6	Dickson, Hugh	Strabane, Ireland	641	242	100	0	0					
" 6	Chatenay, Abel	5 Rue de la Paix, Paris	621	787	265	0	0					
" 6	McArthur, George	Spencer House, London, E.C.	597	125	275	0	0					
" 8	Pirrie, Lawrence	Altwood Road, Maidenhead	540	338	500	0	0	1,140	0	0	36	

and then the necessary credits are made in the accounts of those shareholders who have paid in advance.

CALLS IN ADVANCE ACCOUNT.

Dr.								Cr.			
19...		L.F.	£	s.	d.	19...		C.B.	£	s.	d.
June 1	To Share Capital Account . . .	46	575	0	0		By Cash—				
						Feb. 8	J. R. Smith .	78	100	0	0
						,, 10	W. White .	81	50	0	0
						Mar. 9	B. Black .	96	200	0	0
						,, 10	R. Green .	98	225	0	0
			£575	0	0				£575	0	0

The interest paid on calls in advance does not, of course, appear in the Share Ledger, the only entry necessary being as follows:—

JOURNAL.

19...		L.F.	£	s.	d.	£	s.	d.
July 31	Interest Account . . . . . . Dr.	49	124	7	6			
	To Sundry Shareholders (set out details) . . .	127				124	7	6
	Being interest at 5% for the half year on calls paid in advance.							

Income tax at the standard rate is deducted from the interest. The treatment of the tax in the company's books will depend on whether it is the custom of the company to show interest payable net or gross in the final accounts. If the former, no book entry is made regarding the tax deducted; if the latter, interest account is debited, and income-tax account credited with the amount in question. The latter is the more usual, and better practice. When cheques for the interest due have been sent to the shareholders the Sundry Shareholders' Account will be closed, and the Interest Account will be transferred in due course to the Profit and Loss Account.

Interest on Calls in Arrear.—The majority of Articles reserve power to charge interest on calls in arrear. Table A fixes the rate at 5%, but sometimes it is as high as 10%. The total amount in arrear at any time is represented by the total of the debit balances of the Allotment and Call Accounts. No entries are made in the Share Ledger. The only entry necessary is as follows:—

JOURNAL.

			Dr.			Cr.		
19...		L.F.	£	s.	d.	£	s.	d.
June 30	Sundry Shareholders (set out details) . . . . Dr.	92	38	9	6			
	To Interest Account	68				38	9	6
	Being interest to date at 6% on calls in arrear.							

If, and when, the interest is paid, the Sundry Shareholders' Account will be automatically closed, and the Interest Account will be transferred in due course to the Profit and Loss Account. Experience proves that it is frequently unwise to take credit in the Profit and Loss Account for this interest until actually received.

Statement in Balance Sheet.—Calls in arrear, or paid in advance, are not extended as separate items in the Balance Sheet. Some examination candidates set out calls in arrear as an asset in the Balance Sheet. Although not incorrect in theory, this treatment is not met with in practice. The modern method illustrated below should be adopted in examination work.

Blanks, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

				£	s.	d.	£	s.	d.
CAPITAL :—									
Nominal—									
100,000 Ordinary Shares of £1 each				100,000	0	0			
100,000 6% Preference Shares of £1 each				100,000	0	0			
				£200,000	0	0			
Issued—									
100,000 Ordinary Shares of £1 each, 15s. per	£	s.	d.						
share called	75,000	0	0						
Calls paid in advance	2,500	0	0						
				77,500	0	0			
100,000 6% Preference Shares of £1 each									
fully called	£100,000	0	0						
Less Calls in arrear	2,000	0	0						
				98,000	0	0			
							175,500	0	0

Dividends.—When the profits of a limited company are divided amongst the proprietors (shareholders) the portion of such distribution received by each shareholder is termed a *dividend*. Almost invariably, companies frame special Articles governing the payment of dividends. These usually follow the Articles in Table A, which provides as follows: (1) dividends are to be declared in general meeting, and no dividend may be declared exceeding the rate recommended by the Directors; (2) interim dividends may be paid; (3) no dividend may be paid except out of profits; (4) dividends may be paid only on the actual amounts paid up on the shares; (5) calls paid in advance carry no right to dividend; (6) Directors may make such reserves as they deem proper prior to the declaration of a dividend. Where Table A is excluded, and no provision is made in the Articles for payment of dividends only on the actual amounts paid up on the shares, dividends are payable on the nominal value of the shares.

With the Balance Sheet and Profit and Loss Account (or Income and Expenditure Account, where applicable) the Directors must submit to the Annual General Meeting a report with respect to the state of the company's affairs, the amount, if any, which they recommend should be paid by way of dividend, and the amount, if any, which they propose to carry to any of the company's reserves (S. 157) (note that this requirement relates only to reserves, which word now has a statutory definition, not to provisions, which remain entirely under the control of the Directors). This report must be attached to every Balance Sheet issued.

Not infrequently, examination questions direct the candidate to provide for the Preference dividend, and then to divide the final balance of profit they arrive at between the Preference and Ordinary (or Preferred Ordinary and Ordinary) Shares in given proportions. When the terms of the question also indicate that calls are in arrear, candidates appear to be uncertain whether to provide for the dividend on the nominal value of the shares, or the actual amount paid up on them. It is suggested that the better course to adopt is to assume that the dividend is paid on the called-up value of the shares, and that the dividends on such shares as are in arrear are impounded as against unpaid calls. In practice, this would probably be the course adopted, unless the Articles forbid it, or Table A has been adopted. A note should be made on the face of the accounts that this course has been followed.

Payment of Dividend out of Profits.—The question what constitutes the profits of a company available for dividend is so large and involved that it cannot be discussed in this work. Students are referred to the author's *Accounting*, pp. 320–329, where the question, "What is the profit of a company?" and the important legal decisions bearing upon the point are dealt with at length. The declaration that "no dividends shall be paid otherwise than out of profits" derives not alone from Table A. It is a fundamental principle of company law. Directors who pay dividends otherwise than out of profits, unless they are misled by *bona-fide* overvaluations or honest mistakes, or by the statements of responsible officials of the company whom they are entitled to trust, do so at their peril (*In re London and General Bank*, [1895]; *Dovey* v. *Cory*, [1901]), etc. The onus of proving that dividends have been paid out of profits is upon the Directors (*Rance's Case*, [1871]).

The following brief summary of the rules laid down in the decided cases is all that is possible in this place, though the student will realise that a decision of the judges is best understood when he has studied the full facts of the case:—

(*a*) To justify a dividend there must be a profit, but, so long as dividends are not paid out of capital, the Courts will not interfere with a proposed dividend, although the principle adopted for ascertaining profit may appear to be unsound.

(*b*) To divide the net income derived from a wasting property (*e.g.* a short leasehold) without providing for the wastage is not *illegal* if the Articles authorise it, although commercially unsound.

(*c*) Loss or depreciation of fixed capital does not prevent payment of a dividend, but loss of circulating capital *must* be made good before a dividend is paid.

(*d*) Realised accretions to capital may be brought into Profit and Loss Account and dealt with accordingly, provided they remain after reviewing the accounts as a whole, and the company's Articles do not prohibit such treatment.

(*e*) Sums written off for depreciation, and profits written off against goodwill, may be applied as profits, if in fact no depreciation has taken place.

(*f*) Profits carried to reserve are still profits unless capitalised. If capitalised on redemption of Redeemable Preference Shares, they remain capital and cannot at any time resume their revenue nature (see p. 304).

" Fixed capital," in the sense employed above, is property acquired and intended to be retained and used in the business with a view to earning profit, *e.g.* a factory, or machinery.

" Working capital " is property acquired or produced with a view to sale, *e.g.* the goods made in the factory.

Directors' Report to Shareholders.—When profits are available for distribution as dividend, it is compulsory for the Directors to set out in their report to the shareholders a brief statement showing the amount available and their recommendations as to its disposal (see pp. 365 and 367).

It would appear necessary to report that no dividend is recommended where such is the case.

At the Annual General Meeting of the company convened to receive the Directors' Report and Accounts, the chairman, after explaining the accounts, proposes their adoption. When this motion has been considered and duly carried, a resolution is then submitted that a dividend at the specified rate or rates shall be paid on a named date. If this resolution is duly carried, the dividend becomes a debt due to the shareholders, but it carries no interest. Being specialty debts, claims to the payment of dividends are not barred until twelve years after they become due for payment (*Artisans' Land and Mortgage Corporation*, [1904]) and an entry in a Balance Sheet of debenture interest or dividend unclaimed is a sufficient " acknowledgment " of the debt within the Civil Procedure Act, 1883, S. 5, and will prevent the claim being barred (*Burnham* v. *Atlantic and Pacific Fibre Importing and Manufacturing Co.* [1928]). One of the conditions for the granting of a Stock Exchange quotation is that the company must undertake never to forfeit dividends.

It was formerly considered that no entry regarding a dividend should be made in the company's books until the due date of payment, and that no entry should appear in the published accounts: this was on the ground that until the members had approved the directors' recommendation there was no liability to pay and no " transaction " to record. However, there was a school of thought, steadily increasing in influence, which took the contrary view, and maintained that although admittedly no legal liability to pay existed at the date the Balance Sheet was being drawn up, nevertheless, a Balance Sheet gave a more informative picture of the position if it set out the state of affairs as it would be if the dividend were approved. The 1948

Act (for the first time) gives statutory force to this point of view: the Eighth Schedule lays down (para. 12 [*h*]) that the Profit and Loss Account must show the aggregate amount of dividends paid *and proposed*, and (para. 8 (1) [*e*]) that the Balance Sheet must (not merely include as a liability but) disclose *separately* the net aggregate amount which is recommended for distribution by way of dividend. Notwithstanding this, it remains true that a dividend is not a debt, and consequently cannot be sued for, until it has been duly declared.

Illustration.

		£
The profit for the year, after deducting all expenses and provisions other than those set out below, amounts to		135,000
To which has to be added the balance brought forward from last year		24,000
		£159,000
Out of which the directors have paid the following dividends, less tax :—		
	£	
The Preference Dividend for the half-year to June 30	5,500	
An interim dividend of 5% on the Ordinary Shares	5,500	
		11,000
Leaving a balance available amounting to		£148,000
This sum the directors recommend should be dealt with as follows :—		
Provision for taxation on the profits of the year :—		
Profits Tax	23,000	
Income Tax	54,000	
Transfer to Stock Replacement Reserve	10,000	
Transfer to General Reserve	20,000	
Payment of Dividends, *less* tax :—		
Preference Dividend for the half-year to December 31	5,500	
Final Dividend of 30% on the Ordinary Shares	16,500	
		129,000
Leaving to be carried forward to next year the balance amounting to		19,000
		£148,000

Preference Dividend Arrears.—It has already been stated that arrears of dividend on cumulative Preference Shares are a doubly *contingent liability* of the Company and they must be noted on the face of the Balance Sheet (Eighth Schedule, para. 11 [3]). The information disclosed must include: (1) the gross amount of the arrears (separately for each class of shares if more than one), and the period or periods during which such arrears have accrued, *e.g.*: "*Note.*—The dividends on the 4½% First Cumulative Preference Shares are in arrear since December 31, 19..., and on the 6% Second Cumulative Shares since June 30, 19..., the amounts of such arrears, before deduction of income tax, being £8,100 and £16,500 respectively." It has already been stated that if the available profits of any one year are insufficient to meet the preference dividends, they accumulate from year to year until sufficient profits have been earned to enable the arrears to be discharged. But since payment is contingent upon sufficient profits being earned, and dividends upon those profits being declared, the liability is not one that can be passed into the books. A note of its existence on the face of the Balance Sheet is all that is necessary. It is not necessary that a company should defer payment of its arrears of preference dividend until it is in a position to discharge the whole of the arrears. Instalments on account of such arrears are frequently paid. No dividends can be paid on the Ordinary or other inferior classes of shares until all the arrears on the Cumulative Preference Shares have been discharged.

Interim Dividends.—Table A authorises Directors to pay such interim dividends as they deem to be justified by the profits of the company, and most companies, whether they do or do not adopt Table A, take power in their Articles to declare such dividends. Interim dividends are paid in anticipation of a final profit for the financial year, usually in respect of the first half of the financial year, and their payment does not require the sanction of a general meeting. Considerable responsibility attends the declaration of interim dividends, and the greatest care is necessary in preparing the interim accounts upon which the distribution is based. All necessary reserves, provisions, and depreciations should be made, and even then the distribution should be at a conservative rate. It would appear that directors are entitled to rely upon *bona-fide* valuations and opinions when estimating profits for the purpose of declaring an interim dividend (*Lucas* v. *Fitzgerald*, [1905]), but such dividends may be rescinded before payment (*Lagunas Nitrate Co.* v. *Schroeder*, [1901]), but no such power exists in respect of a final dividend once it has been declared (*Severn and Wye Railway Co.*, [1896]).

Book Entries.—There are two alternative methods of treatment, according to whether the company's practice is to show the dividends net or gross in its published accounts. The method recommended, and now almost universally adopted, is to show all dividends paid "net," *i.e.* to disclose only the actual amount which is paid to the members in all instances, that is to say including those cases where income tax has in fact been deducted. If the dividend is paid "free of tax" no question arises; this is the only possible method. If the dividend is declared at the "actual" or "gross" rate, tax must be deducted, but if, as recommended above, dividends are shown "net" in the published accounts, they will also be shown "net" in the books, no entry whatever being made in regard to the tax which has been deducted. All that is necessary in this case is to debit Profit and Loss Account and credit Dividend Account with the net amount of the dividend (either through the Journal or by direct transfer according to the accountant's taste), and on payment credit the Cash Book and debit Dividend Account, thus closing it.

If, on the other hand, the dividends are disclosed "gross," that is if the amount appearing in the published Profit and Loss Account is the amount of the dividend before deduction of tax, then the other method should be used in the books. This involves an additional journal entry or transfer debiting the Dividend Account and crediting Income Tax Account with the amount of tax deducted. If this method is used the entries are:—

JOURNAL.

		Dr. £ s. d.	Cr. £ s. d.
19... Feb. 3	Profit and Loss Account (Appropriation Section) . Dr. To Dividend Account . . . . Being amount of dividend at 10% on the 100,000 Ordinary Shares as per Shareholders' Resolution, January 30, 19...		
" 3	Dividend Account . . . . Dr. To Income Tax Account . . . . . . Being tax at ... in the £ upon the dividends payable to the ordinary shareholders as above.		

Unless the dividend is "free of tax" (*i.e.* without deduction of tax, and is a short way of saying "a dividend at such rate as, after deduction of tax at the standard rate, will be equivalent to a net rate of ...%") tax will be deductible, and the rate of tax deducted will be the standard rate in force on the due date of payment, without reference to the rate or rates which may have been in force during the period in which the profits in question were earned.

It should be understood that though, in theory, the above remarks regarding the treatment of dividends are equally applicable to dividends received as well as dividends paid, as well as to interest receivable or interest payable, the recommendation as to showing them "net" is intended to apply only to dividends paid, not to dividends received nor to interest whether received or paid. It is generally better, though there may be reasons to the contrary in particular cases, to show all these "gross."

It is of interest at this point to consider the effect of each alternative method of treatment on the Income Tax Account. Considering, for the sake of simplicity, only the position as it is affected by a dividend *payable* (it can easily be seen that exactly similar considerations apply to the payment or receipt of interest or to dividends receivable) we see that if the dividend is shown "net," there is no entry in the Income Tax Account arising in connection with the dividend: as a result, the balance on the Income Tax Account simply represents the tax paid (subject possibly to reserves or provisions, of course, but for the present purpose we can ignore those). It is clear therefore that the whole amount of tax paid by the company will appear in the Profit and Loss Account without deduction, in other words the Profit and Loss Account will disclose the company's total tax liability. If on the other hand, dividends are shown gross, Income Tax Account is credited with the amount of tax deducted, and the balance, disclosed in the Profit and Loss Account, will represent the difference between the total tax paid and the amount recouped by the company by deduction from the dividends, that is to say it will represent the net tax actually borne by the company itself.

Needless to say, it is absolutely necessary in the published Profit and Loss Account to use wording which will make it clear which method has been adopted, *e.g.*:—

Ordinary dividend of 6% gross.
Interim dividend on the Ordinary Shares of 4%, less tax.

This requirement is specifically stated in the Eighth Schedule (para. 14 [4]).

Sometimes, instead of a debit direct to Profit and Loss Account, the following alternative entries are made:—

JOURNAL.

				Dr.			Cr.	
19...		L.F.	£	s.	d.	£	s.	d.
Feb. 5	Dividend Account . . . . . . Dr.							
	To Sundry Shareholders (Dividend, etc.) . . .							
	For dividend at 10%, etc., etc.							
" 5	Sundry Shareholders . . . . . Dr.							
	To Income Tax Account							
	Being tax at ...... in the £, etc.							

In due course, when the Profit and Loss Account is being prepared, the Dividend Account is transferred to the debit of the Appropriation Section.

For the payment of dividends a separate banking account should be opened, and the net sum (*i.e.* the gross amount of the dividend less tax) should be transferred by the bank from the debit of the general banking account to the credit of the dividend banking account. Where shares of different classes are issued, this practice should be followed for each class of share. All dividend warrants presented for payment will be debited by the bank to this account, which will automatically close unless a balance remains thereon because some of the warrants have not been presented for payment. Any such balance will represent the amount of " unclaimed dividends."

Unclaimed Dividends.—When the warrants become " stale," the amount of the unclaimed dividends should be set out in the Balance Sheet as a separate liability. (See the *Burnham Case*, however, on p. 366.) In some cases, a separate account is kept at the bank to which all unclaimed dividends are transferred. If no separate account is kept for this purpose, the balance of the Dividend Account will be transferred to the general banking account after a lapse of, say, three months. Old-established companies frequently accumulate a considerable sum from unclaimed dividends.

Illustration.—Soleil d'Or, Ltd., published accounts for the year ended December 31, 19..., showing a net profit of £8,624. At the annual meeting on February 5 it was resolved to transfer £1,000 to Reserve Account, making that account £5,000 in all, to confirm the Directors' recommendations to pay a dividend of 10% less tax on the Ordinary Share Capital of £50,000, and to carry forward the balance to next year. All dividend warrants were presented for payment as on March 1, with the exception of a warrant for £55 (J. Smith), which was still outstanding. Assume Income Tax at 9s. in the £. Make the necessary entries to carry out the above resolutions.

JOURNAL.

36

			Dr. £	s.	d.	Cr. £	s.	d.
Date		L.F.	£	s.	d.	£	s.	d.
19... Dec. 31	Profit and Loss Account (Appropriation Section). Dr. To Dividend Account . . . . For dividend at 10% less tax at 9s. on 50,000 Ordinary Shares of £1 each as per resolution.	41 81	2,750	0	0	2,750	0	0
" 31	Profit and Loss Account (Appropriation Section). Dr. To Reserve Account . . . . Transfer to the latter Account as per resolution.	41 105	1,000	0	0	1,000	0	0

PROFIT AND LOSS ACCOUNT.

41 Dr. — 41 Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Dividend Account	36	2,750	0	0	19... Dec. 31	By Balance brought down . .	√	8,624	0	0
" 31	" Reserve Account .	36	1,000	0	0						
" 31	" Balance carried down . .	√	4,874	0	0						
			£8,624	0	0				£8,624	0	0
						19... Dec. 31	By Balance brought down . .	√	4,874	0	0

DIVIDEND ACCOUNT.

81 Dr. — 81 Cr.

		J.	£	s.	d.			J.	£	s.	d.
19... Mar. 1	To Cash . . .	93	2,695	0	0	19... Dec. 31	By Profit and Loss Account . .	36	2,750	0	0
" 1	" Balance carried down . .	√	55	0	0						
			£2,750	0	0				£2,750	0	0
						19... Mar. 1	By Balance brought down (J. Smith unclaimed) .	√	55	0	0

CASH BOOK.

93 Dr. — 93 Cr.

			£	s.	d.				£	s.	d.
						19... Mar. 1	By Sundry Dividend Warrants presented to date .	81	2,695	0	0

Note.—In practice, this amount would have been arrived at by the transfer to Dividend Banking Account of £2,750, and the return, on March 1, of £55 unclaimed at that date, the two entries (debit and credit) in the Cash Book resulting in the above balance of £2,695.

RESERVE ACCOUNT.

105 Dr. — 105 Cr.

			£	s.	d.			J.	£	s.	d.
						19... Dec. 31	By Balance brought forward . .	√	4,000	0	0
						"	" Profit and Loss Account .	36	1,000	0	0
									£5,000	0	0

Income Tax on Dividends.—It will be clear to the student that companies *must* deduct tax from Preference or other dividends of *fixed* amount, otherwise the preferential rate of dividend will be exceeded to the detriment of the Ordinary Shareholders. A fixed Preference dividend of 5% paid "free of tax" would in effect amount to a dividend of 9·09%, assuming the tax to be 9*s*. in the £. Dividends on Ordinary Shares are in a different category, and companies, if they so desire, may elect to send out the warrants as "tax free." This expression is not, however, a happy one. No dividend is free from the obligation of income tax. The effect of paying a dividend "free of tax" is simply to increase the rate of dividend by the amount of tax at the current rates.

Reference to the specimen dividend warrant given on p. 377 will show that the gross amount of the dividend, the amount of the tax deducted, and the net amount of the warrant are clearly stated in accordance with the Income Tax Act 1952, S. 199. The warrant also certifies the due payment of the tax, and is accepted by the Authorities in support of claims for repayment of income tax or relief. The amount of tax deducted from dividends is not remitted to the Inland Revenue Authorities, but simply reduces the amount of net tax which is ultimately borne by the company.

EXAMINATION QUESTION.

The capital of Christines, Ltd., consisted of £100,000, divided into 40,000 8% Preference Shares of £1 each and 60,000 Ordinary Shares of £1 each. The whole of this capital was fully paid up.

The profits of the company for the year ended December 31, 19... amounted to £18,782.

The Directors decided to allocate this profit as follows:—

(*a*) To pay the Preference Dividend due for the year.
(*b*) To pay a dividend of 10%, free of tax, on the Ordinary Shares.
(*c*) To open a Reserve Account and transfer £5,000 thereto.
(*d*) To carry forward the balance to next year.

Give the entries necessary to record this decision in the books of the company. (*Royal Society Arts.*)

Solution.

Note.—The standard rate of tax is assumed to be 9*s*.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

(APPROPRIATION SECTION.)

Dr. Cr.

			£	s.	d.				£	s.	d.
19.. Dec. 31	To 8% Preference Dividend Account less tax	6	1,760	0	0	19.. Dec. 31	By Balance brought down . .	√	18,782	0	0
" 31	" Ordinary Dividend Account	4	6,000	0	0						
" 31	" Transfer to Reserve Account	3	5,000	0	0						
" 31	" Balance carried down .	√	6,022	0	0						
			£18,782	0	0				£18,782	0	0
						19.. Dec. 31	By Balance brought down . .	√	6,022	0	0

4 **ORDINARY DIVIDEND ACCOUNT.** 4

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Cash . .	C.B. 12	6,000	0	0	19... Dec. 31	By Profit and Loss Account . .	2	6,000	0	0

6 **8% PREFERENCE DIVIDEND ACCOUNT.** 6

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Cash . .	C.B. 12	1,760	0	0	19... Dec. 31	By Profit and Loss Account . .	2	1,760	0	0
			£1,760	0	0				£1,760	0	0

8 **RESERVE ACCOUNT.** 8

Dr. Cr

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Profit and Loss Account .	2	5,000	0	0

12 **CASH BOOK.** 12

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Ordinary Dividend Account	4	6,000	0	0
						" 31	" 8% Preference Dividend Account . .	6	1,760	0	0

Note.—The cash entries are made on the assumption that the directors' "decisions" in the question were duly approved by the members and carried into effect. Instructions to this effect are not included in the question as set, but are assumed in order to give a complete answer.

Scrip Dividends.—Where its Articles so permit, a company may distribute a "free of tax" dividend in the form of shares or debentures in other companies. This amounts simply to dividing investments among the shareholders instead of realising them and paying cash. The appropriation of profits for the dividend is made in the usual manner.*

Illustration.—The Directors of Rayon d'Or, Ltd., whose summarised Balance Sheet, as at June 30, 19..., is as set out on p. 374, decided to recommend a "free of tax" dividend at the rate of 10% per annum on the Ordinary Share capital for the year ended June 30, 19..., to be satisfied by the distribution

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* See also p. 304 as to the utilisation of the Capital Redemption Reserve Fund for the issue of bonus shares in certain circumstances.

[illegible]

Rayon d'Or, Ltd.

BALANCE SHEET [illegible]

	£	s.	d.		£	s.	d.
Issued Capital.—				Sundry Assets	[illegible]		
[illegible] Preference Shares of £1 each, fully paid	[illegible]			Investment in [illegible] Shares of £1 each fully paid in Soleil d'Or, Ltd., at cost	[illegible]		
[illegible] Ordinary Shares of £1 each, fully paid	[illegible]						
Sundry Liabilities	[illegible]						
	£[illegible]				£[illegible]		

(2) Rayon d'Or, Ltd.

JOURNAL.

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
[illegible] 1	Profit and Loss Account, Appropriation Section . . Dr.		5,000	0	0			
	To Ordinary Dividend Account					5,000	0	0
	Being dividend at the rate of [illegible]% per annum "free of tax" declared this day.							
" 1	Ordinary Dividend Account . . . . Dr.		[illegible]	0	0			
	To Investment in Soleil d'Or, Ltd.					[illegible]		
	Being satisfaction of Dividend by the transfer of [illegible] shares of £1 each, fully paid at par in Soleil d'Or, Ltd.							

NOTES.—(1) The difference between the par and book values (£[illegible]) of the shares transferred may be credited to a Capital Reserve, but it is more prudent to retain it in the Investment Account until it is seen what the remaining shares realise.

(2) The transfers would go before the Directors of Soleil d'Or, Ltd., in the usual way, and the necessary entries made in the Register of Members. No other entries would be required unless a Register of Transfers had to be written up.

Dividend Book or Sheets.—It is usual and useful to prepare a set of ruled sheets to record the details of the payment of a dividend, or to keep a conveniently ruled book to record details of a series of dividends. The ruling of such a book will be found on p. 376.

Dividend Warrants.—The instrument by means of which the payment of dividends is effected is called a Dividend Warrant. Specimens of such documents, reproduced from an Inland Revenue circular, are given on p. 377.

These warrants serve several purposes. They provide: (a) notice and particulars of the Dividend payable to the shareholder; (b) a certificate of the amount deducted for income tax; (c) a cheque in payment of the amount due. The lower portion of the warrant is paid into the payee's bank, the upper part being retained by him. The payee's signature on the face of the cheque instead of the usual indorsement facilitates rapid reference when the warrants are filed, and is convenient for audit purposes. S. 33 of the Finance Act, 1924, requires every warrant to show: (*a*) the gross amount which after deduction of tax corresponds to the net amount actually paid; (*b*) the rate and the amount of tax appropriate to such gross amount; (*c*) the net amount paid. Failure to comply with these requirements renders defaulters liable to a fine.

Payment of Dividends Direct to Banker.—It is a growing and useful practice for shareholders to instruct the companies to pay dividends direct to their bankers. Most companies welcome this practice, and, on request, will supply printed forms containing the necessary instructions to be filled in, signed, and returned by the shareholder. Warrants drawn under such authority are made payable, *e.g.* to " The National Provincial Bank Limited for the account of ......," and are acknowledged by the bank to the companies, they being authorised to accept the bank's receipt as a full discharge. When a number of instructions are received to pay dividends to various accounts at the same bank, it is customary to send one cheque only to the bank covering all dividends due, accompanied by the individual counterpart warrants. This practice saves time and stamp duty. The companies should make a note in their Share Registers, and Dividend Books, if kept, of the receipt of all such instructions.

Closing the Register.—The student may have seen in the public Press, under the headings of the companies concerned, notices to the following effect: " Blanks, Ltd. Notice is hereby given that the registers of all classes of shares in the above company will be closed from February 1 to February 14, 19..., both days included." Such a notice means that no transfers of shares will be registered by the company during the fourteen days indicated, the registers being closed for the purpose of preparing dividend lists for the shares as registered on February 1. Persons buying or selling shares between these dates must settle the ownership of the dividend about to be declared on them as between themselves. If the shares are sold *cum div.*, the purchase price of the shares will be increased by the amount of the dividend, and the dividend will belong to the purchaser; if they are sold *ex div.*, the dividend will belong to the seller. The company will pay the dividend to the registered holder of the shares at the date when the register was closed, and if the shares have been sold *cum div.*, the buyer will claim the amount from the seller. Closure usually starts about a fortnight before the date of the Annual General Meeting and lasts for fourteen days. Normally, quoted shares are made *ex div.* on the Stock Exchange Account day following the declaration of the dividend, provided the Transfer Books have already been closed. If the Transfer Books are not closed until after the dividend has been declared, the securities are made *ex div.* on the account day following the closing of the Books.

Rayon d' Or, Ltd.

DIVIDEND SHEET.

(ORDINARY SHARES.)

Dividend at 5% per annum payable on the 15th day of March, 19..., in respect of the year ended December, 31, 19...

Folio Share Register.	No. of Dividend Warrant.	Payees.		Payee's Holding.	Dividend at . %.	Income Tax Deducted at . in the £.	Net Amount of Warrant.	Date Cleared at Bank.	Remarks.
		Name.	Address.						
					£ s. d.	£ s. d.	£ s. d.		
									When directions are received to pay dividends to shareholders' Bankers, notes are made here of the Banks in question. Sometimes a special column is employed for this purpose.

Note. Separate Dividend Sheets should be employed for each class of share in respect of which dividends are paid. When complete, the loose sheets should be bound in book form.

Example (1).

(*Form for Dividend "Less Income Tax."*)

The X Y Z Company, Limited.

127 *Concord House,*
London, E.C. 2.

No. 7641.

December 1, 19...

To *James Scott.*

A dividend at the rate of 5% *per annum* on the *Ordinary* Shares of the Company having been duly declared for the *year* ended *September* 30, 19..., I beg to forward you the annexed warrant for the amount in respect of the shares registered in your name.

	£	s.	d.
1,200 *Ordinary* Shares of £1 each at 5% . . .	60	0	0
Less Income Tax at 9*s*. 0*d*. in the £ . . .	27	0	0
Net amount of Warrant . . .	£33	0	0

I hereby certify that Income Tax on the profits of the Company, of which profits this dividend forms a portion, has been or will be duly paid to the proper Officer for the receipt of Taxes.

J. Grant, *Secretary.*

This portion of the sheet should be preserved, as it will be accepted by the Inland Revenue authorities in connection with any claim to allowance or relief from Income Tax.

Example (2).

(*Form for Dividend "Free of Income Tax."*)

The X Y Z Company, Limited.

127 *Concord House,*
London, E.C. 2.

No. 7641.

December 1, 19...

To *James Scott.*

A dividend at the rate of 5% *per annum,* "free of Income Tax," on the *Ordinary* Shares of the Company having been duly declared for the *year* ended *September* 30, 19..., I beg to forward you the annexed warrant for the amount in respect of the shares registered in your name.

	£	s.	d.
1,200 *Ordinary Shares* of £1 *each* at 5% . . .	£60	0	0
This dividend is equivalent to a gross amount of	109	1	10
Less Income Tax at 9*s*. 0*d*. in the £ . . .	49	1	10
Net amount of Warrant . . .	£60	0	0

I hereby certify that Income Tax on the profits of the Company, of which profits this dividend forms a portion, has been or will be duly paid to the proper Officer for the receipt of Taxes.

J. Grant, *Secretary.*

This portion of the sheet should be preserved, as it will be accepted by the Inland Revenue authorities in connection with any claim to allowance or relief from Income Tax.

Stale and Lost Warrants.—Dividend warrants usually bear a note to the effect that payment will be refused unless they are presented within six months of the date of issue. A stale warrant unpresented, or presented and refused, may be submitted to the secretary of the issuing company, for verification, and may be presented or re-presented for payment on his authority. Usually, this authorisation is in the form of an indorsement of the warrant:—

Please Pay

BLANKS, LTD.,

GEORGE WILLIAMS,

26/10/19... *Secretary.*

If a warrant is reported lost, the company will issue a duplicate, provided that it is indemnified against loss by the shareholder.

Dividends on Bearer Securities.—It has already been explained that bearer securities are usually accompanied by a sheet of coupons which entitle the bearer to payment of the specified interest on the dates named thereon. Listing forms can be obtained from the company, and must usually be prepared and handed, with the coupons, to the holder's banker, who will collect the dividend due as if he were collecting a cheque, tax being deducted at the standard rate. If no coupons are issued, the holder of a share warrant must deposit it with the secretary for verification. If in order, the warrant will be returned to him together with a cheque for the amount due, *less* tax.

Dividend Reserve Account.—Some companies maintain such an account for the purpose of equalising dividends as between lean and prosperous years. Such a reserve is useful in the case of companies whose profits fluctuate widely, and tends to steady the market price of the shares. To fulfil its purpose satisfactorily, a fund of this kind should be invested outside the business in sound securities.

Bonus Shares as Dividend.—A successful company may have accumulated a large Reserve Account out of profits. The expansion of the company has necessitated increased working capital, and, to obtain this, the company has retained profits in the business instead of distributing them "up to the hilt." In these circumstances, the market value of the shares is sure to appreciate, and the premium may become so high as gravely to restrict the market for the shares. For these, and other financial reasons, a distribution of part, or of the whole, of the accumulated reserve may be desirable. Such a distribution will be *intra vires* if the Articles of the company give power to issue "bonus shares." The procedure adopted is to transfer such part of the reserve as may be necessary to the credit of Profit and Loss Account, or Bonus Dividend Account, and to declare a dividend payable in fully paid shares instead of in cash. Generally an agreement is entered into by the company with X on behalf of the shareholders providing for payment not in cash but in shares; and this agreement is approved by the company in general meeting. Recipients of dividends taking the form of bonus shares are not liable to sur-tax in respect thereof, unless the distribution includes such an option to take either shares or cash as to constitute it income. Recent cases indicate that the decision of the company as to whether the distribution is capital or income holds good, provided the decision is supported by the facts. The shares have already, of course, paid income tax, since the reserve has been accumulated out of profits on which the company was assessed in the usual course. As to the capitalisation of profits on redemption of Redeemable Preference Shares, see pp. 304 and 390.

Financial companies, sometimes, also distribute shares they have acquired in the course of flotations, or other transactions, amongst their shareholders in the form of dividends payable in kind. Again, companies in need of further working capital may secure the capital by declaring a dividend payable in shares, the necessary funds being provided out of profits. Further, shares not fully called may be called up as to the balance, the necessary funds being provided by a distribution from reserve.

Illustration.—Soleil d'Or, Ltd., was registered with a nominal capital of £100,000 in shares of £1 each. £75,000 of this capital was issued, subscribed, and fully paid. The Company proved prosperous, and, on December 31, 19..., had accumulated a Reserve Fund of £55,000. On the same date it was resolved to distribute a portion of the Reserve Fund and to declare a bonus dividend in the shape of an issue of one fully paid share of £1 to every two shares held. The entries are as follows:—

JOURNAL.

7

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Reserve Fund . . . . . . Dr.	1	37,500	0	0			
	To Bonus Dividend Account	5				37,500	0	0
	Being transfer from Reserve to provide for the Bonus distribution passed this day.							
" 31	Bonus Dividend Account . . . . Dr.	5	37,500	0	0			
	To Ordinary Share Capital Account	3				37,500	0	0
	Being the issue of 37,500 new Ordinary Shares in accordance with the terms of the resolution, dated December 31, 19...							

1 **RESERVE FUND.** 1

Dr.		J.	£	s.	d.		Cr.		£	s.	d.
19... Dec. 31	To Bonus Dividend Account .	7	37,500	0	0	19... Dec. 31	By Balance . .	√	55,000	0	0
" 31	" Balance carried down . .	√	17,500	0	0						
			£55,000	0	0				£55,000	0	0
						19... Dec. 31	By Balance brought down . .	√	17,500	0	0

3 **ORDINARY SHARE CAPITAL ACCOUNT.** 3

Dr.			£	s.	d.		Cr.		£	s.	d.
						19... Dec. 31	By Balance . .	√	75,000	0	0
						" 31	" Bonus Dividend Account .	J.7	37,500	0	0
									£112,500	0	0

Note.—The Company would have to increase its Capital to the required amount before the distribution could be made.

5 **BONUS DIVIDEND ACCOUNT.** 5

Dr.		J.	£	s.	d.			J.	£	s.	d. Cr.
19...						19...					
Dec. 31	To Ordinary Share Capital Account	7	37,500	0	0	Dec. 31	By Reserve Fund	7	37,500	0	0
			£37,500	0	0				£37,500	0	0

Alternative entries are as follows:—

Reserve Account . . . . Dr.
To Profit and Loss Account . .
Profit and Loss Account . . Dr.
To Sundry Shareholders . . .
Sundry Shareholders . . . Dr.
To Share Capital Account . . .

If the shares of the Company are not fully paid, and the Bonus is to be utilised to meet a final call of 5s. per share, instead of calling upon the shareholders to find the cash, the entries would be:—

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
19...							
Dec. 31	*Final Call Account . . . . . . Dr.*	*25,000*	*0*	*0*			
	To Share Capital Account				*25,000*	*0*	*0*
	Being Final Call of 5s. per share on 100,000 shares made this day.						
" 31	*Sundry Shareholders . . . . . Dr.*	*25,000*	*0*	*0*			
	To Final Call Account				*25,000*	*0*	*0*
	Being call of 5s. per share due this day.						
" 31	*Reserve Account . . . . . . Dr.*	*25,000*	*0*	*0*			
	To Sundry Shareholders				*25,000*	*0*	*0*
	Being Bonus declared this day.						

If the Company so elects, the Bonus Shares may be issued at a premium; in which case the entry would be:—

Profit and Loss Account . . Dr.
To Sundry Shareholders . . .
,, Premiums on Shares Account . .

Or, alternatively, as shown in the illustration on p. 358.

Illustration 2.—Rayon d'Or, Ltd., was registered with a nominal capital of £200,000 in shares of £1 each. 100,000 of these shares were issued, subscribed, and fully paid up. On December 31, 19..., the market quotation for the shares was 2¼–2⅜.

The directors decided to declare a dividend payable by the issue of one £1 share, taken at the price of £2, for every fifty £1 shares held. The necessary funds were to be provided out of profits, the credit balance of the Profit and Loss Account being £10,286.

The necessary entries are:—

9 JOURNAL. 9

			Dr. £	s.	d.	Cr. £	s.	d.
19...								
Dec. 31	Profit and Loss Account . . . . . Dr.	3	4,000	0	0			
	To Bonus Dividend Account	5				4,000	0	0
	Being transfer of funds to provide for the issue of 2,000 new £1 shares at £2 each as per resolution this day.							
" 31	Bonus Dividend Account . . . . . Dr.	5	4,000	0	0			
	To Sundries :—							
	Share Capital Account	1				2,000	0	0
	Premium on Shares Account	7				2,000	0	0
	Being transfers recording the issue of 2,000 new shares and the premium of £1 per share.							

1 SHARE CAPITAL ACCOUNT. 1

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Balance . .	√	100,000	0	0
						,, 31	,, Bonus Dividend Account .	J. 9	2,000	0	0
									£102,000	0	0

3 PROFIT AND LOSS ACCOUNT. 3

Dr. Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Bonus Dividend. Account .	9	4,000	0	0	19... Dec. 31	By Balance . .	√	10,286	0	0
,, 31	,, Balance carried down . .	√	6,286	0	0						
			£10,286	0	0				£10,286	0	0
						19... Dec. 31	By Balance brought down . .	√	6,286	0	0

5 BONUS DIVIDEND ACCOUNT. 5

Dr. Cr.

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Share Capital Account .	9	2,000	0	0	19... Dec. 31	By Profit and Loss Account .	9	4,000	0	0
,, 31	,, Premium on Shares Account	9	2,000	0	0						
			£4,000	0	0				£4,000	0	0

7 PREMIUM ON SHARES ACCOUNT. 7

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
						19... Dec. 31	By Bonus Dividend Account .	9	2,000	0	0

Illustration 3.—Assume that the bonus distribution is made to meet payment of the uncalled portion of the share capital. The entries in this case are exactly on the lines of those illustrated in (2) above. The Reserve Fund, or Profit and Loss Account, as the case may be, is debited with the amount necessary to meet the call, and the Bonus Dividend Account is credited with a similar amount. The Bonus Dividend Account is then debited, and Final Call Account credited, with the same amount. This entry completes the payment in full of the shares. Final Call Account is closed by transfer to the credit of Share Capital Account.

EXAMINATION QUESTION.

The Annual Accounts of Rayon d'Or, Ltd., showed a balance to the credit of Profit and Loss Account of £5,950 as on December 31, 19... The Nominal Capital of the Company consisted of 10,000 shares of £1 each, all of which had been subscribed and fully paid up.

At the Annual Meeting in February 19... it was decided: (*a*) To increase the Nominal Capital of the Company to £15,000 by the issue of 5,000 6% Preference Shares of £1 each. (*b*) To pay a dividend for the year 19... of 55%, 50% to be discharged by the issue of fully paid Preference Shares at par, and the balance 5% to be paid in cash.

Give the entries necessary to record these transactions. (*Royal Society Arts.*)

Solution.

Note.—The standard rate of income tax is assumed to be 9*s.*

Rayon d'Or, Ltd.

1 PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

(Appropriation Section.)

Dr. Cr.

			£	*s.*	*d.*				£	*s.*	*d.*
19... Feb. 28	To Ordinary Share Dividend .	3	5,275	0	0	19... Dec. 31	By Balance brought down . .	√	5,950	0	0
" 28	" Balance carried down . .	√	675	0	0						
			£5,950	0	0				£5,950	0	0
						19... Feb. 28	By Balance brought down . .	√	675	0	0

3 ORDINARY SHARE DIVIDEND ACCOUNT. 3

Dr. Cr.

			£	*s.*	*d.*				£	*s.*	*d.*
19... Feb. 28	To Preference Share Capital Account	9	5,000	0	0	19... Feb. 28	By Profit and Loss Account .	1	5,275	0	0
" 28	" Cash . .	C.B. 7	275	0	0						
			£5,275	0	0				£5,275	0	0

5 ORDINARY SHARE CAPITAL ACCOUNT. 5

Dr. Cr.

			£	*s.*	*d.*				£	*s.*	*d.*
						19... Dec. 31	By Balance .	√	10,000	0	0

7 CASH BOOK. 7

Dr. Cr.

			£	*s.*	*d.*				£	*s.*	*d.*
						19... Feb. 18	By Sundry Shareholders. Dividend at 5%, less tax at 9s. in the £ .	3	275	0	0

9 6% PREFERENCE SHARE CAPITAL ACCOUNT. 9

Dr.		£	s.	d.	Cr.			£	s.	d.
					19... Feb. 28	By Transfer from Dividend Account . .	3	5,000	0	0

The above entries are frequently the only ones made in actual practice. In the author's opinion, such transactions should be journalised to secure a sequential record. The examination candidate may answer questions of this type by submitting either Journal or Ledger entries—both cannot fairly be expected in a speed test. The Journal entries are set out below, and subject, of course, to the examiner's specific instructions would gain equal marks.

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Profit and Loss Account (Appropriation Section) . Dr. To Ordinary Share Dividend Account . . . . Being dividend at 55% on 10,000 Ordinary Shares of £1 each, less income tax at 9*s.* on the portion payable in cash.	5,275	0	0	5,275	0	0
„ 31	Ordinary Share Dividend Account . . . Dr. To 6% Preference Share Capital Account . . Being dividend at 50% satisfied by the issue, as fully paid, of 5,000 6% Preference Shares of £1 each.	5,000	0	0	5,000	0	0
„ 31	Ordinary Share Dividend Account . . . Dr. To Cash (Bank) . . . . Being dividend of 5% payable in cash *less* tax at 9*s.* in the £.	275	0	0	275	0	0

Forfeiture and Re-issue of Shares.—Companies have no statutory right to forfeit shares. The Act is silent on the matter, but provision is made in the statutory form of the Annual Return for details of any shares forfeited. Power to forfeit shares should be taken in the Articles. Practically, all companies take this power, and their Articles regulating forfeiture follow in the main those of Table A. If a company's Articles are silent on the subject of forfeiture, and Table A is not excluded, Articles 33–39 of Table A (23–29 of Table A under the Act of 1929) apply automatically.

The usual procedure is to send a formal notice to the member whose calls are in arrear requesting payment, reminding him that interest will be charged on the unpaid calls, and that, if the notice is not complied with, the shares are liable to forfeiture. If this notice fails, it is followed by a second demanding payment of the calls and interest thereon, and intimating that, in the event of non-compliance, the shares will be forfeited on a date not less than fourteen days from the date of the notice. Both these notices are sent by registered post. Should the second notice prove ineffectual, a resolution is then passed by the Directors forfeiting the shares, and notice of the fact is sent to the shareholder. Departure from the procedure laid down in the case of forfeiture may invalidate the forfeiture. The procedure must be exactly pursued, and every condition precedent complied with. "A very little inaccuracy is as fatal as the greatest" (James, L. J., *Johnson* v. *Lyttle's Iron Agency*, [1877]).

Some students appear to think that when shares are forfeited they are cancelled. This, of course, is not the case, since such a proceeding would amount to a reduction of capital, which can be effected only by leave of the Court. Forfeited shares become the property of the company, and may be re-issued at any price which, together with the amount paid on them by the original holder, will produce 20*s.* in the £. Thus, if X. Y. was allotted 100 £1 shares in Blanks, Ltd., and had paid 10*s.* per share upon them, but failed to pay the remaining 10*s.*, calls being duly made, the Directors could, after following the procedure outlined above, forfeit the shares and re-issue them as fully paid to A. B. at the price of 10*s.* per share, making 20*s.* in all. Forfeited shares may be re-issued as partly paid, so long as the re-issue is not tantamount to an issue at a discount, otherwise the new holder becomes liable for the amount of the discount in addition to the unpaid calls when these are made in due course. Of course, if shares issued at a discount under S. 57 are forfeited, the amount of the discount must be taken into account.

Illustration.—X. Y., a shareholder in Blanks, Ltd., was allotted 200 ordinary shares of £1 each. He paid 5*s.* per share on application, and 5*s.* per share on allotment, but failed to pay the first and final call of 10*s.* per share. On June 30, 19..., the directors passed a resolution forfeiting the shares under the powers conferred upon them by the Articles.

The nominal capital of the company consisted of 100,000 shares of £1 each, all of which had been issued and subscribed.

The necessary entries are as follows:—

JOURNAL.

		L.F.	Dr. £	s.	d.	Cr. £	s.	d.
19... June 30	Ordinary Share Capital Account . . . . Dr.	1	200	0	0			
	To Forfeited Shares Account	3				200	0	0
	Being 200 Ordinary Shares, fully called up, forfeited as per resolution of the Directors, dated this day.							
,, 30	Forfeited Shares Account . . . . . Dr.	3	100	0	0			
	First and Final Call Account	5				100	0	0
	Being the amount remaining unpaid on the 200 Ordinary Shares forfeited as per previous entry.							

Blanks, Ltd.

LEDGER.

ORDINARY SHARE CAPITAL ACCOUNT.

I Dr. I Cr.

		J.	£	s.	d.				£	s.	d.
19... June 30	To Forfeited Shares Account .	7	200	0	0	19... June 1	By Balance . .	√	100,000	0	0
,, 30	,, Balance carried down . .	√	99,800	0	0						
			£100,000	0	0				£100,000	0	0
						19... June 30	By Balance brought down . .	√	99,800	0	0

LEDGER—*continued.*

FORFEITED SHARES ACCOUNT.

3 Dr. | Cr. 3

		J.	£	s.	d.			J.	£	s.	d.
19...						19...					
June 30	To First and Final Call Account .	7	100	0	0	June 30	By Share Capital Account .	7	200	0	0
„ 30	„ Balance carried down . .	√	100	0	0						
			£200	0	0				£200	0	0
						19...					
						June 30	By Balance brought down . .	√	100	0	0

FIRST AND FINAL CALL ACCOUNT.

5 Dr. | Cr. 5

			£	s.	d.			J.	£	s.	d.
19...						19...					
June 30	To Balance brought forward . .	√	100	0	0	June 30	By Forfeited Shares Account .	7	100	0	0

Blanks, Ltd.

BALANCE SHEET, JUNE 30, 19...

(LIABILITIES SIDE ONLY.)

	£ s. d.	£ s. d.
CAPITAL :—		
Nominal—		
100,000 Ordinary Shares of £1 each	100,000 0 0	
Issued—		
100,000 Ordinary Shares of £1 each, fully called . . .	100,000 0 0	
Less 200 shares forfeited as per resolution of Directors, dated June 30, 19...	200 0 0	
		99,800 0 0
Forfeited Shares Account, amount paid on shares forfeited as above		100 0 0

An alternative, and more direct, method is as follows :—

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
19...							
June 30	Ordinary Share Capital Account . . . . Dr.	200	0	0			
	To First and Final Call Account				100	0	0
	„ Forfeited Shares Account . . .				100	0	0
	Being 200 Ordinary Shares, fully called up, forfeited as per resolution of the Directors, dated this day.						

Most companies, however, prefer the method set out on the previous page.

Re-issue of Forfeited Shares.—In the illustration given above, the company has received £100 = 10*s*. per share on the 200 shares forfeited by X. Y. The issued capital of the company has been reduced by 200 shares, as shown in the Balance Sheet. Although, if the Articles so provide, a defaulting shareholder is still liable for the unpaid calls on forfeited shares, it is the usual practice to treat the unpaid calls as a bad debt, and to take steps to re-issue the shares to a fresh holder. Assuming that, in the illustration given above, the 200 shares are re-issued on July 30, 19..., to R. Y., at the price of 10s. per share, the entries would be as follows:—

JOURNAL.

8

			Dr.			Cr.		
		L.F.	£	s.	d.	£	s.	d.
19... July 30	Forfeited Shares Re-issued Account . . . . Dr.	5	200	0	0			
	To Ordinary Share Capital Account	1				200	0	0
	Being re-issue of 200 Ordinary Shares forfeited on June 30, 19...							
„ 30	Sundries . . . . Dr.	C.B.						
	Cash (New Shareholder)	7	100	0	0			
	Forfeited Shares Account	L.F. 3	100	0	0			
	To Forfeited Shares Re-issued Account	5				200	0	0
	Being amount already received and Cash paid by R. Y. on re-issue of 200 Ordinary Shares as above.							

LEDGER.

ORDINARY SHARE CAPITAL ACCOUNT.

1

Dr.											Cr.
			£	s.	d.				£	s.	d.
19... July 30	To Balance carried down . .	√	100,000	0	0	19... June 30	By Balance brought down . .	√	99,800	0	0
						July 30	„ Forfeited Shares Re-issued Account . .	J. 8	200	0	0
			£100,000	0	0				£100,000	0	0
						19... July 30	By Balance brought down . .	√	100,000	0	0

FORFEITED SHARES ACCOUNT.

3

Dr.											Cr.
		J.	£	s.	d.				£	s.	d.
19... July 30	To Forfeited Shares Re-issued Account . .	8	100	0	0	19... June 30	By Balance brought down . .	√	100	0	0

FORFEITED SHARES RE-ISSUED ACCOUNT.

5

Dr.											Cr.
		J.	£	s.	d.			J.	£	s.	d.
19... July 30	To Ordinary Share Capital Account . .	8	200	0	0	19... July 30	By Sundries .	16	200	0	0

CASH BOOK.

(DEBIT SIDE ONLY.)

7

Dr.					Cr.
			£	s.	d.
19... July 30	To Cash. R. Y., in respect of 200 Ordinary Shares reissued . .		100	0	0

The more direct method of entry is shown in the next example.

Re-issue of Forfeited Shares at a Premium.—If forfeited shares are re-issued at a higher price than the amount outstanding upon them, the extra amount received represents a premium, and should be treated as a capital profit and used to strengthen the company's reserves. Reverting again to the illustration given above, and assuming that the 200 shares in question were sold to R. Y. for £150, the necessary entries would be as follows:—

JOURNAL.

		Dr.			Cr.		
		£	s.	d.	£	s.	d.
19... July 30	Sundries :— Dr.						
	R. Y. (Cash)	150	0	0			
	Forfeited Shares Account	100	0	0			
	To Sundries :—						
	Ordinary Share Capital Account				200	0	0
	Premium on Shares Account				50	0	0
	Being re-issue of 200 Ordinary Shares forfeited to R. Y. at the price of £150 as per resolution of even date.						

10 LEDGER. 10

PREMIUM ON SHARES ACCOUNT.

Dr.						Cr.				
			£	s.	d.				£	s.	d.
						19... July 30	By R. Y. re-issue of 200 shares	J.	50	0	0

The premium on shares, £50, would appear on the liabilities side of the Balance Sheet as a separate item after the statement of Share Capital.

EXAMINATION QUESTION.

The Directors of Blanks, Ltd., decided to forfeit 500 Ordinary Shares, standing in the name of X. Y. Z., on the ground that the final call of 5*s.* per share remained unpaid after several applications.

The Company's £1 Ordinary Shares were issued at a premium of 2*s.* 6*d.* per share, and were payable as follows: On application (May 1), 5*s.* per share; on allotment (May 15), 7*s.* 6*d.* per share, including the premium; on June 1, 5*s.* per share; on July 1, 5*s.* per share.

Give the entries necessary to record this forfeiture. (*Royal Society Arts.*)

Solution.

3 JOURNAL.

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
19... Aug. 1	Ordinary Share Capital Account Dr.	1	500	0	0			
	To Forfeited Shares Account	5				500	0	0
	Being 500 Ordinary Shares of £1 each, fully called up, forfeited by resolution of the Directors, dated							
" 1	Forfeited Shares Account Dr.	5	125	0	0			
	To Second Call Account.	7				125	0	0
	Being amount (5*s.* per share) unpaid on 500 shares forfeited as above.							

LEDGER.

ORDINARY SHARE CAPITAL ACCOUNT.

(Say 50,000 Shares of £1 each.)

1 Dr.

Cr. 1

19...		J.	£	s.	d.	19...			£	s.	d.
Aug. 1	To Forfeited Shares Account	3	500	0	0	May 1	By Application Account	J.	12,500	0	0
" 1	" Balance carried down	√	49,500	0	0	" 15	" Allotment Account	J.	12,500	0	0
						June 1	" 1st Call Account	J.	12,500	0	0
						July 1	" 2nd Call Account	J.	12,500	0	0
			£50,000	0	0				£50,000	0	0
						19... Aug. 1	By Balance brought down	√	49,500	0	0

PREMIUM ON SHARES ACCOUNT.

3 Dr.

Cr. 3

			£	s.	d.	19...			£	s.	d.
						May 15	By 2s. 6d. per share on 50,000 shares	J. 3	6,250	0	0

FORFEITED SHARES ACCOUNT.

5 Dr.

Cr. 5

19...		J.	£	s.	d.	19...		J.	£	s.	d.
Aug. 1	To Second Call Account	3	125	0	0	Aug. 1	By Ordinary Share Capital Account	3	500	0	0
" 1	" Balance carried down	√	375	0	0						
			£500	0	0				£500	0	0
						19... Aug. 1	By Balance brought down	√	375	0	0

SECOND CALL ACCOUNT.

7 Dr.

Cr. 7

19...			£	s.	d.	19...			£	s.	d.
July 1	To Share Capital Account	1	12,500	0	0	July 1	By Cash, Sundry Shareholders	C.B.	12,375	0	0
						" 1	" Forfeited Shares Account	J. 3	125	0	0
			£12,500	0	0				£12,500	0	0

The Application and Allotment, and First Call Accounts would duplicate the Second Call Account given above, except that the credit entry would be "By Cash, £12,500," and need not be repeated here. The tendency of many candidates is to write back the premium of 2*s*. 6*d*. per share on X. Y. Z.'s 500 shares. The premium would, of course, be forfeited, together with the amounts paid on Application and Allotment, and First Call Accounts, and would remain in the Premium on Shares Account as shown above.

In view of the provisions of S. 75 that a transfer of shares must not be registered except on production of an instrument of transfer, it would appear to be necessary for a nominee of the company to execute a transfer to the person to whom the shares are re-issued.

Surrender of Shares.—Shares may be surrendered if the Articles authorise surrenders, but to avoid a technical reduction of capital, the sanction of the Court must first be obtained, unless the circumstances of the case justify the ordinary procedure of forfeiture. Forfeiture is the best and shortest course to pursue in suitable circumstances. Surrendered shares may be re-issued on the principles already explained in connection with forfeited shares. The most common circumstances leading to a surrender of shares arise in connection with the purchase of a business, or assets which turn out to be less valuable than was assumed at the time of purchase.

Illustration.—A. B. sold his business to Blanks, Ltd., as a going concern for £100,000, payable as to £25,000 in cash and £75,000 in fully paid shares. The stock taken over fell heavily in value owing to market depreciations and some large book debts proved to be irrecoverable. In view of this, A. B. agreed to surrender £25,000 of the shares allotted to him. Assuming the surrender to have been effected with the sanction of the Court and by the ordinary process of surrender, the effect on the company's Balance Sheet would be as follows:—

Blanks, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.			£	s.	d.
Capital:—					Purchase of Business Account	£100,000			
75,000 Ordinary Shares of £1 each issued as fully paid	£75,000				*Less* shares surrendered by A. B.	25,000			
Less shares surrendered by A. B.	25,000						75,000	0	0
		50,000	0	0					

Liens and Charges on Shares.—The majority of Articles provide that the company shall have a lien on shares and dividends, for calls or debts due from members to the company. The rules of the Stock Exchange prohibit the extension of this power to fully paid shares.

As an alternative to forfeiture, therefore, the company may sue the defaulting member, or may stand on its lien, and sell the shares. Table A empowers the company to sell shares on which it has a lien for moneys presently payable, after giving the defaulter at least fourteen days' notice in writing of the intention to do so if the moneys are not paid. The company can authorise a nominee to execute a transfer giving effect to the sale. The defaulter is entitled to any surplus realised.

Loans are frequently obtained from bankers and others on the security of shares. It is not usual for an actual transfer of the shares to be registered by the company in favour of the lender. Generally the borrower deposits with the lender his share certificate or certificates, accompanied by a transfer in blank, *i.e.* a transfer with no transferee's name filled in. This gives the lender an equitable title to the shares. The company is not affected by this procedure, since companies must take no notice of equities or trusts. But, although the company cannot register a notice of any equitable interest of third parties, it loses its own priority of lien on receipt of such notice (*Bradford Banking Co.* v. *Briggs* [1886]). The lender takes the risk of fraud on the part of the borrower, or of bankruptcy proceedings being instituted against him. But he can protect himself by applying for, and filing with the Supreme Court, a document termed a *Notice in Lieu of Distringas.* A certified copy of this notice when served on the company will prevent the transfer of the shares, or the payment of dividends, without prior notice being given to the lender.

Redemption of Redeemable Preference Shares.—The law regulating such redemption has been stated on p. 304. It is now sufficient to give an illustration.

Illustration.—Uprichards, Ltd., had issued 20,000 Redeemable Preference Shares of £1 each, redeemable on September 30, 19..., at 22*s.* 6*d.* per share. On that date, the company had a Reserve of £14,000 and a balance at the credit of Profit and Loss Account of £500, and the directors decided to issue 6,400 Ordinary Shares at a premium of 5*s.* per share and to apply the proceeds, together with the existing balances at the credit of the Reserve and Profit and Loss Account, in redeeming the Preference Shares. Show by Journal entries the records of these transactions.

The new Ordinary Shares will realise £8,000, and this sum, together with the balance of £14,000 on General Reserve and £500 at the credit of Profit and Loss, makes up in all £22,500, exactly sufficient to redeem the Preference Shares. The difference between the nominal value of the Preference Shares (£20,000) and the Ordinary Shares (£6,400) is £13,600, and this sum must therefore be transferred to a Capital Redemption Reserve Fund, in order to comply with S. 58.

JOURNAL.

		Dr.			Cr.		
		£	s.	d.	£	s.	d.
19..	Cash :— Dr.	8,000	0	0			
	To Ordinary Shares				6,400	0	0
	„ Share Premium Account				1,600	0	0
	Redeemable Preference Shares Dr.	20,000	0	0			
✓	Premium on Redemption of Preference Shares Dr.	2,500	0	0			
	To Cash				22,500	0	0
	Sundries :— Dr.						
	To Sundries :						
	Viz.—						
	General Reserve	14,000	0	0			
	Profit and Loss Account	500	0	0			
	Share Premium Account	1,600	0	0			
	Premium on redemption of Preference Shares				2,500	0	0
	Capital Redemption Reserve Fund				13,600	0	0

It will be noted that the premium on redemption has been provided partly out of profits and partly out of the Share Premium Account, as laid down by S. 58(1)(*c*).

Issue of Debentures.—The opening entries necessary for recording an issue of debentures are similar to those required for recording an issue of shares. For example:—

JOURNAL.

		Dr.			Cr.		
19...		£	s.	d.	£	s.	d.
Dec. 12	Debenture Application and Allotment Account Dr. To 5% Debentures Account						
" 12	Debenture Call Account . . . . Dr. To 5% Debentures Account . . . . (and so on)						

Separate Application and Allotment Sheets, Cash Book, and Banking Account should be opened in the case of a large issue of debentures in order to facilitate registration and audit. Debentures are usually payable in full, either on application or by two or three instalments over a short period.

Issue of Debentures at a Premium.—Debentures, like shares, may be issued at any premium that can be commanded. The entries necessary are similar to those required for a share issue at a premium.

Illustration.—Uprichards, Ltd., offered for subscription on December 12, 19..., 1,000 5% Debentures of £100 each at the price of £110, payable as to £20 on application and £90 (including the premium) on allotment. The whole issue was subscribed and allotted, and the moneys due were paid on or before December 18, 19...

JOURNAL.

		Dr.			Cr.		
19...		£	s.	d.	£	s.	d.
Dec. 18	Debenture Application and Allotment Account Dr.	110,000	0	0			
	To 5% Debenture Account . .				100,000	0	0
	" Premium on Debentures Account . .				10,000	0	0
	Being £20 per debenture of £100 on application and £90 on allotment as per resolution of the Directors, dated December 1, 19...						

The Ledger accounts will be similar to those already illustrated in the case of an issue of shares at a premium.

As with premiums on shares, so with premiums on debentures, it is suggested that they should be separately stated on the liabilities side of the Balance Sheet and treated as a capital reserve, although here also, in the absence of express prohibition to the contrary in the Articles, there appears to be nothing to prevent such profits from being treated as ordinary revenue.

Issue of Debentures at a Discount.—Debentures may be issued at a discount if so authorised by the Articles. But where they are so issued, the terms of issue may not include an option to convert the debentures into their par value of fully paid shares, for that would be tantamount, if taken advantage of, to an issue of shares at a discount—an illegal proceeding (*Moseley* v. *Koffyfontein Mines*, [1904]), unless the shares are validly issued at a discount under S. 57. Students appear to find difficulty in the fact that whereas debentures may, shares may not, except under S. 57, be issued at a discount. The reason is that a shareholder is really equivalent to a partner in the company, whereas the debenture holder is a creditor of the company. The amount of discount on debentures, or shares (issued under S. 57), and any commissions payable on the issue, must be stated in the Prospectus (Fourth Schedule), and must be set out separately in the company's Balance Sheet until written off (Eighth Schedule, para. 3), The discount must also be stated in the Annual Return (Sixth Schedule, Part II).

Issues at a discount seem to present difficulties to some students, but, carefully considered, the procedure is quite simple. The essential fact to remember is that the company is under liability to repay the *full face value* of the debentures on maturity. The issue to-day of a £100 debenture at £95, repayable ten years hence, means that although upon issue the company receives but £95, it will have to pay £100 on the date of maturity. The company must therefore acknowledge the full liability for £100 in its books, and treat the £5 discount as a temporary asset, and write it off during the life of the debenture. This discount practically amounts to deferred interest paid in a lump sum upon maturity of the debenture.

The simple rule to remember is:—

(a) *Credit Debentures Account with the full amount repayable on maturity, and* (b) *debit to Discount on Debentures Account the difference (discount) between* (a) *and the actual cash received.*

Illustration.—On January 1, 19..., Soleil d'Or, Ltd., offered for subscription 550 5% Debentures of £100 each at the price of 95, payable as to £20 on application, £40 on allotment, and £35 on March 1, 19... The whole issue was subscribed and allotted, and the amounts due were paid on or before March 1, 19....

JOURNAL. 1

			Dr.			Cr.		
		L.F.	£	s.	d.	£	s.	d.
19.. Jan. 3	Debenture Application and Allotment Account . . . Dr.	6	33,000	0	0			
	To 5% Debentures Account	5				33,000	0	0
	Being £20 on application, and £40 on allotment, on 550 5% Debentures issued at 95 as per resolution of Directors, dated January 5, 19...							
Mar. 1	Debenture Final Call Account . . . . Dr.	8	19,250	0	0			
	To 5% Debentures Account	5				19,250	0	0
	Being final call of £35 per debenture on 550 5% Debentures issued at 95 as above.							
,, 1	Debenture Discount Account . . . . . Dr.	7	2,750	0	0			
	To 5% Debentures Account	5				2,750	0	0
	Being discount at £5 per debenture on 550 5% Debentures issued at 95 as above.							

LEDGER.

5% DEBENTURES ACCOUNT.

5 Dr. Cr. 5

			£	s.	d.			J.	£	s.	d.
						19... Jan. 5	By Debenture Application and Allotment Account .	1	33,000	0	0
						Mar. 1	„ Final Call Account . .	√	19,250	0	0
						„ 1	„ Debenture Discount Account .	√	2,750	0	0
									£55,000	0	0

DEBENTURE APPLICATION AND ALLOLMENT ACCOUNT.

6 Dr. Cr. 6

		J.	£	s.	d.			C.B.	£	s.	d.
19... Jan. 1	To 5% Debentures Account .	1	33,000	0	0	19... Jan. 5	By Cash . .	3	33,000	0	0
			£33,000	0	0				£33,000	0	0

DEBENTURE FINAL CALL ACCOUNT.

7 Dr. Cr. 7

		J.	£	s.	d.			C.B.	£	s.	d.
19... Mar. 1	To 5% Debentures Account .	1	19,250	0	0	19... Mar. 1	By Cash . .	3	19,250	0	0
			£19,250	0	0				£19,250	0	0

DEBENTURE DISCOUNT ACCOUNT.

8 Dr. Cr. 8

		J.	£	s.	d.				£	s.	d.
19... Mar. 1	To 5% Debentures Account .	1	2,750	0	0						

CASH BOOK.

3 Dr. Cr. 3

			£	s.	d.				£	s.	d.
19... Jan. 5	To Cash, Sundry Debenture Holders Application and Allotment .	6	33,000	0	0						
Mar. 31	To Cash, Debenture Final Call Account . .	7	19,250	0	0						

EXAMINATION QUESTION.

A limited company having decided to issue £10,000 5% debentures, namely, 100 of £100 each at a discount of 5%, arrange with Softleigh & Co. to underwrite the whole issue at a commission of 5% on the nominal value. In due course 90 debentures were subscribed, paid for, and allotted, the remaining 10 debentures being allotted to Softleigh & Co. as per their underwriting agreement. You are required to show the accounts in the Company's books necessary to record these transactions, including the account with Softleigh & Co., also state how the debentures will appear on the next Balance Sheet of the Company.

Solution.

JOURNAL.

16

		Dr. £	s.	d.	Cr. £	s.	d.
Debenture Application and Allotment Account . Dr.	3	8,550	0	0			
To 5% Debentures					8,550	0	0
Being 90 debentures of £100 each issued at a discount of 5% to the public as per resolution of Directors, dated							
Softleigh & Co. (Underwriters) . Dr.	9	950	0	0			
To 5% Debentures	5				950	0	0
Being 10 debentures at a discount of 5% not taken up by the public and now allotted to the underwriters as per resolution of Directors, dated							
Debenture Discount . Dr.	7	500	0	0			
To 5% Debentures	5				500	0	0
Being 5% discount on 100 debentures of £100 each.							
Debenture Issue Expenses Account . Dr.	11	500	0	0			
To Softleigh & Co.	9				500	0	0
Being 5% underwriting commission on 100 debentures of £100 each.							

CASH BOOK.

1 Dr. — Cr. 1

Dr.		£	s.	d.	Cr.	£	s.	d.
To Cash, Sundry Debenture Holders (Application and Allotment Moneys)	3	8,550	0	0				

LEDGER.

Debenture Application and Allotment Account.

3 Dr. — Cr. 3

Dr.	J.	£	s.	d.	Cr.	C.B.	£	s.	d.
To 5% Debentures Account	16	8,550	0	0	By Cash	1	8,550	0	0

5% Debentures Account.

5 Dr. — Cr. 5

Dr.	£	s.	d.	Cr.	J.	£	s.	d.
				By Debenture Application and Allotment Account	16	8,550	0	0
				,, Softleigh & Co.	—	950	0	0
				,, Debenture Discount Account	—	500	0	0
						£10,000	0	0

Debenture Discount Account.

7 Dr. — Cr. 7

Dr.	J.	£	s.	d.	Cr.	£	s.	d.
To 5% Debentures Account	16	500	0	0				

9 **Softleigh & Co.** 9

Dr.	J.	£	s.	d.	Cr.	J.	£	s.	d.
To 5% Debentures Account . .	16	950	0	0	By Underwriting Commission .	16	500	0	0
					„ Balance carried down . .	√	450	0	0
		£950	0	0			£950	0	0
To Balance brought down . .	√	450	0	0					

11 **Debenture Issue Expenses Account.** 11

Dr.	J.	£	s.	d.	Cr.	£	s.	d.
To Softleigh & Co., Underwriting Commission .	16	500	0	0				

BALANCE SHEET.

	£	s.	d.		£	s.	d.
5% Debentures :— 100 Debentures of £100 each .	10,000	0	0	Debenture Discount Account .	500	0	0
				Debenture Issue Expenses Account	500	0	0
				Sundry Debtors (Softleigh & Co.) .	450	0	0
				Cash	8,550	0	0

Purchase of Debentures in Open Market.—When the conditions of issue, or the provisions of the Trust Deed, empower a company to redeem its debentures by purchasing them in open market, the necessary entries are as follows:—

Illustration.—Uprichards, Ltd., in conformity with their Debenture Trust Deed, purchased the following debentures: March 15, from John Smith, five 5% debentures of £100 each at £102; March 26, from Wm. Robinson, six 5% debentures of £100 each at £98. The expenses in connection with the purchases were £5. Ignore accrued interest.

In actual practice, the cash purchases of debentures would pass through the Cash Book. The double-entry aspect of the transactions as a whole is set out in the Journal entries given below.

JOURNAL.

13

		Dr. £	s.	d.	Cr. £	s.	d.
Debenture Purchase Account . . . . . Dr.	3	1,098	0	0			
To Sundries :—							
John Smith	7				510	0	0
William Robinson	9				588	0	0
Being purchase of £500 Debentures at 102, and £600 at 98 respectively.							
5% Debenture Stock Account . . . . Dr.	5	1,100	0	0			
To Debenture Purchase Account	3				1,100	0	0
Being debentures purchased as above.							
Debenture Purchase Expenses Account . . Dr.	11	10	0	0			
To Debenture Purchase Account . .	3				10	0	0
Being premium on purchase from John Smith as above.							
Debenture Purchase Account . . . . Dr.	3	12	0	0			
To Debenture Purchase Expenses Account .	11				12	0	0
Being discount on purchase from William Robinson as above.							

CASH BOOK.

2 Dr. | Cr. 2

			£	s.	d.				£	s.	d.
						19..					
						Mar. 15	By John Smith .	7	510	0	0
						,, 26	,, Wm. Robinson .	9	588	0	0
						,, 26	,, Expenses on Debenture Purchases	11	5	0	0

LEDGER.

Debenture Purchases Account.

3 Dr. | Cr. 3

		J.	£	s.	d.			J.	£	s.	d.
19...						19...					
Mar. 15	To John Smith .	13	510	0	0	Mar. 26	By 5% Debenture Stock Account .	13	1,100	0	0
,, 26	,, Wm. Robinson .	13	588	0	0	,, 26	,, Debenture Purchases Expenses Account . .	13	10	0	0
,, 26	,, Debenture Purchases Expenses Account . .	13	12	0	0						
			£1,110	0	0				£1,110	0	0

5% Debenture Stock (Trustees') Account.

5 Dr. | Cr. 5

		J.	£	s.	d.				£	s.	d.
19...											
Mar. 26	To £1,100 Debentures Purchased .	13	1,100	0	0						

John Smith.

7 Dr. | Cr. 7

		C.B.	£	s.	d.			J.	£	s.	d.
19...						19...					
Mar. 15	To Cash	2	510	0	0	Mar. 13	By £500 Debentures.	13	510	0	0

William Robinson.

9 Dr. | Cr. 9

		C.B.	£	s.	d.			J.	£	s.	d.
19...						19...					
Mar. 26	To Cash	2	588	0	0	Mar. 26	By £600 Debentures.	13	588	0	0

Debenture Purchases Expenses Account.

11 Dr. | Cr. 11

		J.	£	s.	d.			J.	£	s.	d.
19..						19..					
Mar. 15	To Debenture Purchases Account .	13	10	0	0	Mar. 26	By Debenture Purchases Account.	13	12	0	0
,, 26	,, Cash	C.B. 2	5	0	0	,, 26	,, Balance carried down . .	✓	3	0	0
			£15	0	0				£15	0	0
19...											
Mar. 26	To Balance brought down . .	✓	3	0	0						

Note.—At the close of the year, the balance of this account would be transferred to Profit and Loss Account. Since the cash resources have been depleted, it is also advisable, in order to preserve working capital, to transfer from Profit and Loss Account (Appropriation Section) to General Reserve Account an amount equal to the cash cost of purchasing the debentures—in this case £1,100 (the other £3 will be written off).

Debenture Issue Expenses.—Considerable expense attaches to a debenture issue. The expenses will probably include: underwriting commission, brokerage paid to stockbrokers and others for placing bonds, advertising, printing, law costs, statutory filing fees, and *ad valorem* duty. These expenses will appear as payments on the credit side of the Cash Book, or as credits to personal accounts, and should be posted to the debit of a separate ledger account headed Debenture Issue Expenses Account. The balance of this account must appear as a separate item in the Balance Sheet (Eighth Schedule, para. 3 (b)), and should be written off in instalments over the life of the debentures, or, preferably, within a shorter period.

In this connection, also, some students appear to find difficulty. Briefly put, these expenses represent an actual *loss* incurred in raising money by means of a debenture issue. Clearly this loss must be extinguished on or before the maturity of the debentures. It is reasonable, however, to assume that all the years between issue and maturity will benefit by the employment of the money borrowed. That being so, it is legitimate to spread the expenses over the life of the issue, although it is preferable to extinguish the item sooner.

If the issue is redeemable by annual drawings of fixed amount, it is theoretically correct to apportion the expenses on the basis of the amount of debentures outstanding, so that all the years which benefit from the loan shall bear their due proportion of the expenses. Practical experience, however, shows that most companies endeavour to eliminate the item more expeditiously than adherence to this theory would permit.

Premiums and Discount in Balance Sheet.—The method of setting out premiums and discount in the Balance Sheet can best be shown by an example:—

Illustration.—The nominal capital of Uprichards, Ltd., consists of £200,000, divided into 100,000 Ordinary Shares of £1 each and 100,000 7% Preference Shares of £1 each. The whole of the shares were offered for subscription. Of the Ordinary Shares, 85,000 were applied for, allotted, and fully called up. All calls were paid, except the final call of 5*s.* per share on 1,000 shares. The Preference Shares were issued at a premium of 2*s.* 6*d.* per share, and were fully subscribed, allotted, and paid up. The company also issued 500 5% debentures of £100 each at 95. The issue was fully subscribed, allotted, and paid up. The expenses of issue were £1,500. The debentures were repayable in five years from the date of issue, and the Directors decided to write off the discount and expenses in equal annual instalments over that period. (Give the necessary entries recording the position at the close of the year immediately following the above issues as shown in the company's Balance Sheet. (*See next page.*)

Debenture Interest.—Interest on debentures is usually payable half-yearly. As it represents interest on a loan, it must be paid whether profits are made or not. Income tax at the current rate must be deducted from the interest when paid. A debenture-interest warrant is illustrated on p. 401.

Debenture Interest Book.—When the debenture holders are numerous, it is usual to keep a Debenture Interest Book. A suitable ruling for this book is given on p. 400.

Debenture Coupons.—Debenture bonds made out to bearer are negotiable instruments. Interest on them is paid by means of detachable Interest Coupons covering a series of years, attached to the bonds.

Uprichards, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
CAPITAL :—													
Nominal—													
100,000 Ordinary Shares of £1 each	100,000	0	0										
100,000 7% Preference Shares of £1 each	100,000	0	0										
	£200,000	0	0										
Issued—													
85,000 Ordinary Shares of £1 each fully called up	85,000	0	0										
Less Calls in arrear	250	0	0										
	84,750	0	0										
100,000 7% Preference Shares of £1 each	100,000	0	0	184,750	0	0							
Share Premium Account				12,500	0	0	Debenture Discount Account	2,500	0	0			
5% Debentures—							*Less* One-fifth written off	500	0	0	2,000	0	0
500 Debentures of £100 each				50,000	0	0	Debenture Expenses Account	1,500	0	0			
							Less One-fifth written off	300	0	0	1,200	0	0

and made payable on the dates when the interest on the bonds falls due. It is usual to keep a *Coupon List* recording the numbers of all bonds issued, and to note therein the due date and payment of the coupons attached to the bonds. A ruling for a Coupon List is illustrated on p. 400.

Entries on Payment of Debenture Interest.—When the debenture interest for a period becomes due the necessary entries are:—

JOURNAL.

			Dr.			Cr.	
		£	s.	d.	£	s.	d.
19...							
Dec. 31	Debenture Interest Account . . . . Dr.	500	0	0			
	To Sundry Debenture Holders				400	0	0
	„ Income Tax				100	0	0
	Being interest for the half-year due this day on £20,000 5% Debentures less tax at 4s. in the £.*						

* Or whatever the current rate of tax may be.

The Sundry Debenture Holders' Account will automatically close when all the interest warrants have been paid. The income tax deducted will, as already explained in connection with the income tax deducted from Dividends, remain at the credit of Income Tax Account pending the final adjustment of all income tax due by the company for the financial period.

In the case of large issues, a separate banking account is opened, the net amount payable to the debenture holders being credited to it by means of a transfer from the main banking account. This banking account will automatically close when all the warrants have been presented and paid.

Unclaimed Debenture Interest.—If, when the annual accounts are prepared, a balance remains on the Sundry Debenture Holders' Account, it will represent unclaimed debenture interest, and should be included as a separate item under the heading "Current Liabilities." If a separate banking account has been opened for the service of debenture interest, a similar amount will remain as a balance in hand, and should be separately stated amongst the various bank balances. If no separate banking account has been opened, the unclaimed interest will, of course, be merged in the general bank balance. See the reference to the *Burnham* case on p. 366 as to such interest becoming Statute barred.

Redemption of Debentures.—With the exception of irredeemable debentures, all loans of this kind are repayable at certain fixed dates. In the case of Governments or Corporations whose issues are popular with investors, a fresh loan is usually relied upon to replace one falling due, and, frequently, holders of the old loan have the option of converting into the new on favourable terms. But in the case of ordinary commercial issues, provision must be made so that the funds necessary for redemption may be available when the issue matures. There are various ways of redeeming debentures. (*a*) A sinking fund may be created by the annual purchase of gilt-edged Stock Exchange securities; (*b*) the debentures may be purchased in the open market; (*c*) a Capital-redemption Policy may be taken out by the company; (*d*) there may be annual drawings of fixed amount.

DEBENTURE INTEREST BOOK.

No. of Interest Warrant.	Debenture Register Folio.	Name of Payee.	Address of Payee.	Debentures Held.			Interest for Half-year to ... at ...%.			Income Tax Deducted. Rate ...			Net Amount of Warrant.			When Paid by Bank.	Remarks.
				£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.		

COUPON LIST.

No. of Bearer Bond.	Date of Issue.	Due Dates of Coupons and Dates Paid.							
		Due.	Paid.	Due.	Paid.	Due.	Paid.	Due.	Paid.

(*Debenture Interest Warrant.*)

UPRICHARDS, LIMITED.

32

532 Oxford Street, W. 1.
January 1, 19...

A. N. Other, Esq.,
Spencer House,
E.C. 2.

This portion of the Interest Warrant to be retained by the Proprietor.

Dear Sir or Madam,

Herewith I have the pleasure to hand you a warrant for the interest on your debenture stock as under for the six months ended December 31, 19..., less Income Tax, which I hereby certify will be accounted for by the Company to the proper officer for the receipt of taxes. This statement will be accepted by the Inland Revenue as proof of payment of the tax in claiming exemption from, or return of, Income Tax.

G. W. Both,
Secretary.

Holding.				
		£	s.	d.
£353	4% 1st Debenture Stock at £2 per £100 Stock	7	1	2
£	4½% 2nd Debenture Stock at £2 5*s.* 0*d.* per £100 Stock			
	Total	7	1	2
	Less Income Tax at 9*s.* 0*d.* in the £ .	3	3	6
	Net Amount . . .	£3	17	8

-------------------- (*Perforation.*) --------------------

UPRICHARDS, LIMITED.

32

Warrant for Interest for Half-year ended December 31, 19...

No. 1243.

To National Provincial Bank, Limited,
Princes Street, E.C.

London,
January 1, 19...

Pay *A. N. Other, Esq.*

Three pounds, seventeen and eight pence.

Stamp

For and on behalf of

£3 17 8.

Uprichards, Limited.

G. W. Both, Secretary.
A. Always, Asst. Secretary.

Signature of Payee....................

This warrant must be presented for payment within six months from date.

Illustration (a). Sinking Fund.—Soleil d'Or, Ltd., issue £100,000 of debentures redeemable in twenty years. It is decided to provide the funds for redemption by an annual investment in first-class securities of a sum which at 3% per annum compound interest will produce the amount required for redemption. The annual sum to be invested is the amount which annually invested at 3% compound interest will in twenty years produce the capital amount to be redeemed. From the Tables we find that the sum required to be invested at 3% compound interest to produce £1 in twenty years is £0·0372. Multiplying this by 100,000, we obtain £3,720 as the annual instalment to be invested at 3% compound interest to produce £100,000 in twenty years. This amount will be appropriated from profits and credited to Redemption of Debentures Sinking Fund Account, and an equivalent amount of cash invested at the beginning of each year. All interest accrued will also be credited to the account and immediately invested. The Journal entry will be as follows:—

JOURNAL.

		Dr.			Cr.		
		£	s.	d.	£	s.	d.
19... Dec. 31	Profit and Loss Account (Appropriation Section) . Dr.	3,720	0	0			
	To Redemption of Debentures Sinking Fund Account				3,720	0	0
	Being the annual instalment required for the redemption of the debentures as per the conditions of issue.						
„ 31	Investment of Sinking Fund Account . . Dr.	3,720	0	0			
	To Cash				3,720	0	0
	Being purchase of investment. (*Note.*—In practice this purchase would be posted direct from the Cash Book—no Journal entry being made.)						

On initiation of the fund, the purchase of the investment (£3,720) will appear as a payment on the credit side of the Cash Book, from which it will be posted direct to the debit of the Investment of Sinking Fund Account. When the second instalment of £3,720 becomes due, it will be added to the interest (£111 12*s.*) received on the first instalment for the first year, and £3,831 12*s.* will be invested; and so on from year to year throughout the twenty years.

The annual appropriations from Profit and Loss Account, and the annual interest received, will be posted to the credit of the Redemption of Debentures Sinking Fund Account; the annual purchases of investments will be credited to Cash and debited to Investment of Sinking Fund Account.

When the debentures mature for payment, the investments will be realised and the proceeds be credited to the Investment of Sinking Fund Account; the debentures will be paid off and the Debentures Account debited with the payment; and the Sinking Fund will be transferred to general reserve, in which it becomes merged.

The relative ledger accounts are simple and need not be illustrated.

An illustration of the purchase of debentures in the open market has already been given on p. 395. It may, however, be useful to extend the principles there illustrated to purchases of debenture stock.

Illustration (b). Purchase in Open Market.—The Articles of Soleil d'Or, Ltd., provide for the purchase of the company's 5% debenture stock in the open market at a price not exceeding £102 per £100 debenture stock. £80,000 of the stock had been issued and fully paid up. During the year 19... the company purchased thirty debentures at 98 in the open market. A circular was sent to every debenture stock holder enclosing a tender form as illustrated on p. 404. Ten debenture stock holders, holding an aggregate of forty debentures, sent in tenders at 97½ per debenture, and these were accepted. All purchases were completed on January 5, 19... Ignore accrued interest

The entries are as follows:—

5% DEBENTURE STOCK.

Dr.									Cr.
		£	s.	d.			£	s.	d.
19... Jan. 5	To Cash, £3,000 Debenture Stock at 98 . . .	2,940	0	0	19... Dec. 31	By Balance . .	80,000	0	0
„ 5	„ Cash, £4,000 Debenture Stock at 97½ . . .	3,900	0	0				
„ 5	„ Discount on Redemption of Debenture Stock Account . .	160	0	0				
„ 5	„ Balance carried down . .	73,000	0	0				
	£80,000	0	0			£80,000	0	0
				19... Jan. 5	By Balance brought down . . .	73,000	0	0

CASH BOOK.

Dr.									Cr.
	£	s.	d.			£	s.	d.
				19... Jan. 5	By Cash, purchase of £3,000 Debenture Stock at 98 .	2,940	0	0
				„ 5	„ Cash, purchase (by tender) of £4,000 Debenture Stock at 97½ . . .	3,900	0	0

DISCOUNT ON REDEMPTION OF DEBENTURE STOCK ACCOUNT.

Dr.									Cr.
	£	s.	d.			£	s.	d.
				19... Jan. 5	By 5% Debenture Stock Account .	160	0	0

It is submitted that the profit on the purchase of debentures should be treated as a capital profit, and not as ordinary revenue. The contention of those who would treat such profits as ordinary revenue is that the saving effected by the redemption represents a capitalised reduction of interest on a debt.

If a direct appropriation from profits is made for the redemption of debentures, a further entry is necessary, viz. debiting Profit and Loss Account (Appropriation Section) and crediting Debenture Redemption Reserve Account or General Reserve Account with the amount appropriated. This is certainly generally advisable, in order that working capital may be preserved.

The amount of the debentures redeemed will, of course, appear in the Balance Sheet as a deduction from the original issue as follows:—

	£	£
5% Debenture Stock:—		
800 Debentures of £100 each	80,000	
Less 70 Debentures of £100 each redeemed to date	7,000	
		£73,000

Sometimes the debentures are held by the Debenture Holders' Trustees, and appear as an investment on the asset side of the Balance Sheet, in which case, of course, no deduction is made from the liability.

TENDER.

SOLEIL D'OR, LIMITED.

5% FIRST MORTGAGE DEBENTURE STOCK.

TENDER OF DEBENTURE STOCK.

.... 19...

To the Directors of
SOLEIL D'OR, LIMITED,
532 OXFORD STREET, W.

I ....

of ....

hereby tender £......... of the above stock registered in my name at £......... per £100 of Debenture Stock, this price to include accrued interest; and if this offer, or any part thereof, be accepted, I hereby undertake to surrender corresponding certificates for the stock, and to execute any transfer of such stock as you may require.

Yours truly,

Signature ....
Address ....
Occupation......................................

Illustration (*c*). *Capital Redemption Policy*.—Soleil d'Or, Ltd., issued £50,000 of 5% debentures, the whole of which were subscribed and fully paid up. In order to provide for the redemption of the debentures, a Capital Redemption Policy was taken out securing the payment of £50,000 on the maturity date of the debentures. The annual premium on the policy was £3,895. The entries are as follows:—

JOURNAL. 8

			Dr.			Cr.		
19...			£	s.	d.	£	s.	d.
Dec. 31	Profit and Loss (Appropriation Section) . . Dr.		3,895	0	0			
	To Sinking Fund for Redemption of Debentures .					3,895	0	0
	Being the annual instalment on the fund for the redemption of the 5% Debentures as per condition of issue.							
" 31	Debenture Recemption Policy Account . . Dr.		3,895	0	0			
	To Cash					3,895	0	0
	Being the annual premium on Policy No. A37452 for the service of the above fund. (*Note*.—This amount would be posted direct from the Cash Book in actual practice.)							

The endowment policy method is probably a little more costly than the investment of the sinking fund in Stock Exchange securities. But it has the advantage of ensuring that the exact sum required will be forthcoming at the maturity date. The investment method can only be approximate, and should depreciation in the investments occur, the sum realised by sale would be inadequate to discharge the debentures.

Illustration (*d*). *Annual Drawings.*—Soleil d'Or, Ltd., issued and allotted £50,000 5% debentures. By the terms of issue, the company was to repay fifty debentures of £100 at par, on December 31 of each year, by annual drawings. The company's profits for the first year were £15,787. The drawing took place, and £5,000 of the stock was duly paid off on January 2, 19....

The necessary entries are:—

5 PROFIT AND LOSS ACCOUNT. 5

Dr. Cr.

19...			£	s.	d.	19...			£	s.	d.
Dec. 31	To Redemption of Debentures Account . .		5,000	0	0	Dec. 31	By Balance brought down . . .		15,787	0	0
„ 31	„ Balance carried down . .		10,787	0	0						
			£15,787	0	0				£15,787	0	0
						19...					
						Dec. 31	By Balance brought down . .		10,787	0	0

109 CASH BOOK. 109

Dr. Cr.

			£	s.	d.	19...			£	s.	d.
						Jan. 5	By Cash, Repayment of Bonds Nos. 12, 72, 89, 98, 108, 112, 128, 142, 172, etc., drawn this day . . .	41	5,000	0	0

71 REDEMPTION OF DEBENTURES ACCOUNT. 71

Dr. Cr.

			£	s.	d.	19...			£	s.	d.
						Dec. 31	By Profit and Loss Account . .	5	5,000	0	0

41 5% DEBENTURES ACCOUNT. 41

Dr. Cr.

19...			£	s.	d.	19...			£	s.	d.
Jan. 5	To Cash	109	5,000	0	0	Dec. 31	By Balance . .	√	50,000	0	0
„ 5	„ Balance carried down . .	√	45,000	0	0						
			£50,000	0	0				£50,000	0	0
						19...					
						Jan. 5	By Balance brought down . .	√	45,000	0	0

Re-issue of Debentures.—Debentures that have been redeemed may be re-issued unless the Articles or the terms of issue forbid that course (S. 90). Sometimes the debentures are merely indorsed with a transfer to the new holder; sometimes they are replaced by fresh bonds. In both cases re-stamping is necessary. No fresh entry in the Register of Charges is required unless a fresh charge is created. The book-keeping entries are simple, viz. a credit to cash and a debit to the old

Debenture Account for the repayment, and a debit to cash of the moneys received, and a like credit to Debentures Account recording the receipt of a new loan in place of the old one discharged. If no cash passes, however, debit the old Debenture Account and credit the new.

Sometimes an entire issue of debentures is redeemed in order to make a fresh issue on more favourable terms.

Illustration.—Soleil d'Or, Ltd., decided to redeem its issue of £50,000 6% debentures repayable in 19... for a fresh issue of 5% debentures for a longer term. The debenture holders were given the option of converting their holdings to the new issue. The offer was accepted, the old bonds were called in and cancelled, and fresh bonds were issued for the new loan.

The old Debenture Account will be closed, and the new account be opened by the following entry:—

8 JOURNAL.

			Dr.			Cr.		
19...			£	s.	d.	£	s.	d.
Dec. 31	6% Debentures Account . . . . . Dr.		50,000	0	0			
	To 5% Debentures Account					50,000	0	0
	Being cancellation of the old series 1–500 and the issue, in exchange, of the new series 501–1000.							

The changes effected must be notified to the Registrar and be recorded in the Register of Charges.

EXAMINATION QUESTION.

A company raises a loan of £500,000 upon Debenture Stock, at a discount of 2½% on January 1, 19... (year 1). The loan is redeemable at par at the end of a period of years, by a cumulative Sinking Fund, but the Company has power to call upon the Trustees to apply the Sinking Fund Investments in the purchase of stock, if below par, at any time. The annual sinking fund contribution, exclusive of interest accumulated, is £12,000. This amount is promptly invested, together with income accumulations, on January 1 in each year; capital balances arising from realisation of investments are re-invested at the same time. The Sinking Fund instalments are calculated on a 3% basis, but are invested to give a higher yield.

Sinking Fund Investments produce interest, less tax, as follows:—

Year 2, £394; Year 3, £608; Year 4, £718.

Realisations of Sinking Fund Investments are as follows:—

	£	s.	d.		£	s.	d.
June 30, Year 2 . .	4,306	5	0	Original cost . .	4,292	10	0
Sept. 30, Year 2 . .	1,280	6	0	Original cost . .	1,310	0	0
August 31, Year 3 .	8,340	0	0	Original cost . .	8,307	10	0
March 31, Year 4 . .	6,180	0	0	Original cost . .	6,160	0	0

The proceeds of realisations are applied in redemption of Stock as follows:—

	£		£
July 31, Year 2	4,305	In cancellation of .	4,563 Stock.
October 31, Year 2 . . .	1,278	In cancellation of .	1,300 Stock.
September 30, Year 3 . .	8,340	In cancellation of .	8,360 Stock.
April 30, Year 4 . . .	6,175	In cancellation of .	6,200 Stock.

Interest is paid on the Loan half yearly on July 1 and January 1.

Prepare accounts in respect of the Sinking Fund transactions given for the years 1 to 4 inclusive, showing the manner in which the Sinking Fund would be compensated for the loss of interest resulting from the realisation of investments. State also how you would deal with the accounts relating to Discount on Issue, Profit on cancellation of Stock, and Profit and Loss on realisation of Investments (*Chartered Accountants*).

For *Solution* see pp. 407–411.

Solution.

DEBENTURE STOCK ACCOUNT.

Dr.		£	s.	d.		Cr.	£	s.	d.
Year 2 July 31	To Cash	4,305	0	0	Year 1 Jan. 1	By Sundries	500,000	0	0
	" Profit and Loss on Cancellation of Debentures Account	258	0	0					
Oct. 31	" Cash	1,278	0	0					
	" Profit and Loss on Cancellation of Debentures Account	22	0	0					
Dec. 31	" Balance carried down	494,137	0	0					
		£500,000	0	0			£500,000	0	0
Year 3 Sept. 30	To Cash	8,340	0	0	Year 3 Jan. 1	By Balance brought down	494,137	0	0
	" Profit and Loss on Cancellation of Debentures Account	20	0	0					
	" Balance carried down	485,777	0	0					
		£494,137	0	0			£494,137	0	0
Year 4 April 28	To Cash	6,175	0	0	Year 4 Jan. 1	By Balance brought down	485,777	0	0
	" Profit and Loss on Cancellation of Debentures Account	25	0	0					
Dec. 31	" Balance carried down	479,577	0	0					
		£485,777	0	0			£485,777	0	0
					Year 5 Jan. 1	By Balance brought down	£479,577	0	0

		£	s.	d.			£	s.	d.
Year 2 Dec. 31	To Profit and Loss on Realisation of Investments Account	15	19	0	Year 1 Dec. 31	By Profit and Loss (Appropriation) Account	12,000	0	0
	" General Reserve	5,863	0	0	Year 2 Dec. 31	By Profit and Loss (Appropriation) Account	12,000	0	0
	" Balance carried down	18,795	1	0		" Interest on Investments	394	0	0
						" Profit and Loss on Cancellation of Debentures Account	280	0	0
		£24,674	0	0			£24,674	0	0
		£	s.	d.			£	s.	d.
Year 3 Dec. 31	To General Reserve	8,360	0	0	Year 3 Jan. 1	By Balance brought down	18,795	1	0
	" Balance carried down	23,095	11	0	Dec. 31	" Profit and Loss on Cancellation of Debentures Account	20	0	0
						" Profit and Loss on Realisation of Investments Account	32	10	0
						" Interest on Investments	608	0	0
						" Profit and Loss Account	12,000	0	0
		£31,455	11	0			£31,455	11	0
		£	s.	d.			£	s.	d.
Year 4 Dec. 31	To General Reserve	6,200	0	0	Year 4 Jan. 1	By Balance brought down	23,095	11	0
	" Balance carried down	29,658	11	0	Dec. 31	" Profit and Loss on Cancellation of Debentures Account	25	0	0
						" Profit and Loss on Realisation of Investments Account	20	0	0
						" Interest on Investments Account	718	0	0
						" Profit and Loss Account	12,000	0	0
		£35,858	11	0			£35,858	11	0
					Year 5 Jan. 1	By Balance brought down	29,658	11	0

SINKING FUND INVESTMENTS ACCOUNT.

Dr.												Cr.
Date	Particulars	£	s.	d.	£	s.	d.	Date	Particulars	£	s.	d.
Year 2 Jan. 1	To Cash, purchase of investments . . .				12,000	0	0	Year 2 June 30	By Cash, realisation	4,306	5	0
June 30	" Profit and Loss on Realisation of Investments Account				13	15	0	Sept. 30	" Cash, realisation	1,280	6	0
									" Profit and Loss on Realisation of Investments Account	29	14	0
								Dec. 31	" Balance carried down	6,397	10	0
					£12,013	15	0			£12,013	15	0
Year 3 Jan. 1	To Balance brought down				6,397	10	0	Year 3 Aug. 31	By Cash, realisation	8,340	0	0
	" Cash, purchase of investments—							Dec. 31	" Balance carried down	10,487	11	0
	Appropriation	12,000	0	0								
	Interest	394	0	0								
	Balance of Investments sold	3	11	0	12,397	11	0					
					18,795	1	0					
Aug. 31	" Profit and Loss on Realisation of Investments Account				32	10	0					
					£18,827	11	0			£18,827	11	0
Year 4 Jan. 1	To Balance brought down				10,487	11	0	Year 4 Mar. 31	By Cash, realisation	6,180	0	0
	" Cash, purchase of Investments—							Dec. 31	" Balance carried down	16,935	11	0
	Appropriation	12,000	0	0								
	Interest	608	0	0	12,608	0	0					
					23,095	11	0					
Mar. 31	" Profit and Loss on Realisation of Investments Account				20	0	0					
					£23,115	11	0			£23,115	11	0
Year 5 Jan. 1	To Balance brought down				16,935	11	0					
	" Cash, purchase of Investments—											
	Appropriation	12,000	0	0								
	Interest	718	0	0								
	Balance of Investments sold	5	0	0	12,723	0	0					
					£29,658	11	0					

PROFIT AND LOSS ON REALISATION OF INVESTMENTS ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
Year 2 Sept. 30	To Sinking Fund Investments Account	29	14	0	Year 2 June 30	By Sinking Fund Investments Account	13	15	0
					Dec. 31	„ Sinking Fund Account	15	19	0
		£29	14	0			£29	14	0
Year 3 Dec. 31	To Sinking Fund Account	£32	10	0	Year 3 Aug. 31	By Sinking Fund Investments Account	£32	10	0
Year 4 Dec. 31	To Sinking Fund Account	£20	0	0	Year 4 Mar. 31	By Sinking Fund Investments Account	£20	0	0

PROFIT AND LOSS ON CANCELLATION OF DEBENTURES ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
Year 2 Dec. 31	To Sinking Fund Account	280	0	0	Year 2 July 31	By Debenture Stock Account	258	0	0
					Oct. 31	„ Debenture Stock Account	22	0	0
		£280	0	0			£280	0	0
Year 3 Dec. 31	To Sinking Fund Account	£20	0	0	Year 3 Sept. 30	By Debenture Stock Account	£20	0	0
Year 4 Dec. 31	To Sinking Fund Account	£25	0	0	Year 4 April 28	By Debenture Stock Account	£25	0	0

GENERAL RESERVE ACCOUNT.

Dr.							Cr.		
		£	s.	d.			£	s.	d.
Year 2 Dec. 31	To Discount on Debentures Account	£5,863	0	0	Year 2 Dec. 31	By Sinking Fund Account	£5,863	0	0
Year 3 Dec. 31	To Discount on Debentures Account	6,637	0	0	Year 3 Dec. 31	By Sinking Fund Account	8,360	0	0
	„ Balance carried down	1,723	0	0					
		£8,360	0	0			£8,360	0	0
Year 4 Dec. 31	To Balance carried down	7,923	0	0	Year 4 Jan. 1	By Balance brought down	1,723	0	0
					Dec. 31	„ Sinking Fund Account	6,200	0	0
		£7,923	0	0			£7,923	0	0
					Year 5 Jan. 1	By Balance brought down	£7,923	0	0

Note.—**It is the better practice to transfer each year to General Reserve a proportion of the Sinking Fund equal to the proportion of the Debenture Stock cancelled, as the Fund has to that extent been utilised for the purpose for which it was created.** It is desirable to write off the Debenture Discount against the amounts so transferred, in order to eliminate the fictitious asset.

There is no need to compensate the Sinking Fund for loss of interest on the investments realised, as debentures have been cancelled therewith. It will, however, be necessary to recompute the Sinking Fund yearly allocations. Alternatively, the Debentures redeemed can be treated as investments on Sinking Fund Account, and a transfer be made each year from Profit and Loss Account to Sinking Fund Account of the interest of such debentures, an equivalent amount of cash being invested on the Fund Account.

Debentures Deposited to Secure Advances.—Not infrequently debentures are issued to a loan creditor, usually the company's bankers, as security for the loan. The nominal value of the debentures deposited generally exceeds the amount of the loan by a margin of from 10% to 15%. In the author's experience, examination candidates frequently err when dealing with an issue of this kind. The simple facts are these: the liability of the company is the amount of the loan, and *not the face value of the debentures.* The debentures are not an ordinary issue for which cash has been subscribed; they are merely issued as additional security for the loan, and are a *contingent liability only.* If the company defaults, the loan creditor can exercise whatever powers the debentures confer upon him in order to protect himself, and he can, in the event of insolvency, claim a dividend on the deposited debentures *pari passu* with other debentures of the series until his loan is paid in full. A note should be made under the heading of the loan ledger account giving particulars of the debentures issued as security. The only other record necessary is a note in the Balance Sheet as under:—

BALANCE SHEET.

(LIABILITIES SIDE.)

Loan from Bankers	£10,000
(Secured by the issue of £11,000 5% debentures.)	

If the loan is paid off, the debentures are not held to be redeemed. They are still available for issue, but may be left on deposit and used to cover future loans (see p. 314).

Balance Sheet and Debentures.—The facts that the Balance Sheet should disclose regarding debentures are as follows:—

(*a*) The amount originally issued, and the redemptions (if any) to date.

(*b*) If issued at a premium, the way the premium has been dealt with, *i.e.* treated as a capital reserve, or as ordinary revenue.

(*c*) If issued at a discount, the total amount of the discount, the amount written off to date, and the amount of the annual instalments.

(*d*) Whether redemption of the debentures is being provided for, and, if so, how.

(*e*) That the debentures have been issued as additional security; if such be the fact, the issue should be entered "short" under the liability secured.

(*f*) Whether all accrued interest has been brought into account.

(*g*) The expenses of issue, so far as they have not been written off (Eighth Schedule, para. 3).

If the company has power to re-issue debentures which have been redeemed, particulars with respect to the debentures which can be so re-issued *must* be included in every Balance Sheet (Eighth Schedule, para. 2 (*d*)).

Statutory Report.—Every company limited by shares, and every company limited by guarantee and having a share capital, must, unless it is a private company, hold a general meeting of its members, not less than one month, or more than three months, from the date on which it is entitled to commence business (S. 130). This meeting is called the *Statutory Meeting*. At least fourteen days before the meeting, a report, known as the *Statutory Report*, must be sent to every member of the company (S. 130 [2]). The Report must be certified by not less than two directors of the company (S. 130 [3]). If this meeting be not held, then, fourteen days after the date on which it should have been held, any shareholder may apply to the Court to have the company wound up (S. 222 [*b*]). But the Court may direct that the meeting shall be held (S. 225 [3]). A copy of the Report must be filed with the Registrar (S. 130 [5]). The Statutory Meeting is not an ordinary general meeting within the meaning of S. 131, and, therefore, no Annual Return need be filed for this meeting. None of these provisions apply to a Private Company (S. 130 [10]).

Statutory Report.—By S. 130 [3] the Report must furnish the following information:—

(*a*) The total number of shares allotted, distinguishing those allotted as fully, or partly, paid up otherwise than in cash, the extent to which they are so paid up, and the consideration therefor.

(*b*) The total amount of cash received by the company in respect of all the shares allotted, distinguished as in (*a*).

(*c*) An abstract of the receipts of the Company and of the payments made from those receipts up to a date within seven days of the date of the report, distinguishing receipts from shares and debentures and those from other sources, the payments made thereout, and particulars of the balance remaining in hand.

(*d*) An account or estimate of the preliminary expenses.

(*e*) The names, addresses, and descriptions of the Directors, Auditors (if any), Managers (if any), and Secretary of the company.

(*f*) Particulars of any contract the terms of which it is proposed to modify, together with particulars of the proposed modification. By S. 42 a public company may not previously to the statutory meeting vary the terms of a contract referred to in the Prospectus or Statement in Lieu except subject to the approval of that meeting.

The Report must be certified by the auditors (if any) (*a*) so far as it relates to the shares allotted by the company; (*b*) as to the cash received in respect of such shares; and (*c*) as to the receipts and payments on capital account (S. 130 [4]).

A list of members, giving their names, addresses, descriptions, and shareholdings must lie on the table at the meeting for inspection (S. 130 [6]).

Statutory meetings are usually brief and formal, and frequently futile. But they afford members an opportunity to ask questions relating to the promotion and formation of the company. But no resolution may be passed notice of which has not been given in accordance with the Articles (S. 130 [7]).

Illustration.—Soleil d'Or, Ltd., was formed to acquire an existing business, and was registered with a nominal capital of 100,000 Ordinary Shares of £1 each. The vendors received 10,000 shares as part payment of sundry assets purchased, and 40,000 shares were allotted to the public. The shares were fully paid up, with the exception of calls amounting to £500 outstanding on three allotments. The preliminary expenses were estimated at £4,000. The trading receipts and payments were £10,321 and £9,670 respectively. £25,000 had been paid to the vendors in accordance with the purchase agreement. The bank balance was £11,971. The Statutory Report in proper form recording this position is given below.

Number of Company, 365.

THE COMPANIES ACT, 1948

REPORT (Pursuant to Section 130 of The Companies Act, 1948)

OF

.... Limited.

A Companies Registration Fee Stamp of 5s. must be *impressed* here.

To be certified by not less than two Directors, and forwarded at least fourteen days before the Statutory Meeting to every Member of the Company, and to be delivered to the Registrar of Companies for registration forthwith after it is so forwarded—Section 130 of The Companies Act, 1948.

Note.—This form has been provided for the purpose of indicating the nature of the information that is required; but as the Report to be filed must be a copy of that sent to the Shareholders, all that is contained in that Report must appear in this. (This is not an official form. Blank forms cannot be obtained from the Registrar of Companies as is the case with official forms such as the Annual Return.)

(*a*) The Total Number of Shares allotted is 50,000 *Ordinary Shares of £1 each*, of which 10,000 *Shares* are allotted[*] *as fully paid up* in consideration of *part of the purchase price of sundry assets acquired by the company*, and upon each of the remaining Shares the sum of £1 has been paid in Cash.

(*b*) The Total Amount of Cash received by the Company in respect of the Shares allotted wholly for Cash is £39,500, and on the Shares allotted partly for Cash is £(*nil*).

(*c*) The Receipts and Payments of the Company made thereout to the 10*th* day of *October*, 19..., are as follows:—

Particulars of Receipts.	£	s.	d.	Particulars of Payments.	£	s.	d.
Amount received on 40,000 Ordinary Shares issued for Cash .	*39,500*	*0*	*0*	*Payments to Vendors in respect of purchase of Land, Buildings, and Machinery* . . .	*25,000*	*0*	*0*
Trading receipts . . .	*10,321*	*0*	*0*	*Preliminary Expenses* . .	*3,180*	*0*	*0*
				Trading payments . . .	*9,670*	*0*	*0*
				Balance at Bank . . .	*11,971*	*0*	*0*
	£49,821	*0*	*0*		*£49,821*	*0*	*0*

---

[*] Here state as "fully paid up" or "paid up otherwise than in cash to the extent of .... per share."

The following is an account (or estimate) of the Preliminary Expense of the Company.

	£	s.	d.
Cost of registration of the Company, underwriting commission, law costs, brokerage, printing and advertising, etc., estimated at .	*4,000*	*0*	*0*

(*d*) Names, Addresses, and Descriptions of the Directors, Auditors (if any), Manager (if any), and Secretary of the Company.

DIRECTORS.

Surname.	Christian Name.	Address.	Description.
MacArthur	*George*	16 *Finsbury Circus, London, E.C.*	*Chartered Accountant*
Goodwin	*Arthur*	*Eastwood, Essex*	*Rose Grower*
Ducher	*Pernet*	*Lyons, Rhône, France*	*Horticulturist*
		AUDITORS.	
Accurate & Co.	—	*Salisbury House, London, E.C.*	*Chartered Accountants*
		MANAGER.	
Richmond	*Robert*	*Rochford, Essex*	*Rose Grower*
		SECRETARY.	
Dixon	*Hugh*	*Rochford, Essex*	*Incorporated Accountant*

(*e*) Particulars of any Contract the modification of which is to be submitted to the Meeting for its approval, together with the particulars of the modification or proposed modification.

The contract set out in the prospectus, and dated July 5, 19..., whereby the services of Robert Richmond were to be secured to the Company for a period of ten years is to be submitted to the meeting with a view to the reduction of the term of years from ten to five.

WE hereby certify this Report.

George MacArthur } Two
Arthur Goodwin } Directors.

WE hereby certify that so much of this Report as relates to the shares allotted by the Company and to the Cash received in respect of such shares and to the receipts and payments of the Company on Capital Account is correct.

Accurate & Co.,
Auditors.

Dated the *10th* day of *October, 19....*

Preliminary Expenses.—An estimate of the preliminary expenses (see above) must be given in the Statutory Report, but no details need be disclosed. A separate account must be opened and debited with all items chargeable to preliminary expenses. If the vendor undertakes to pay all expenses up to allotment, the account is a personal account as against the vendor. If the promoter is liable for Preliminary Expenses, particular care is necessary that all legitimate expenses are charged to his account. To this end it is useful to add an extra column in the Cash Book for the accommodation of these charges. If the company bears the cost of the formation or promotion expenses, it is legitimate to "hold up" the expenditure as a temporary asset to be written off in instalments spread over from three to five years. The preliminary expenses must be stated under a separate heading on the Balance Sheet, so far as they are not written off (Eighth Schedule, para. 3 [*a*]). Any expenses of a share issue must be similarly stated (Eighth Schedule, para. 3 [*b*]). The position should be clearly shown in the Balance Sheet thus:—

BALANCE SHEET.

(ASSETS SIDE.)

	£	£
Preliminary Expenses Account	7,863	
Less One-third written off this year . . .	2,621	
		5,242

Inasmuch as the company could not have been formed without expenditure of this kind, it is reasonable to treat the outlay as temporary capital expenditure spread over a period of years. Legal sanction for this treatment is afforded by the case of *Bale* v. *Cleland*. Instalments written off preliminary expenses are not allowed as a deduction for income tax, the Revenue authorities claiming that it is capital expenditure. Actual purchases, *e.g.* the seal, stationery, account books, etc., are, however, allowed. It is a growing modern practice to contract with a promoting syndicate for the formation of the company, and the underwriting of its capital for an inclusive fee.

Splitting Shares.—Limited companies, if so authorised by their Articles, have power to subdivide, or "split" their shares into shares of smaller denomination than that fixed by the Memorandum of Association (S. 61, 1 [*d*]). Not infrequently, prosperous companies, whose capital was originally issued in shares of large denomination, find the market for their shares hampered by that fact, and therefore take advantage of the power conferred by this section to alter their Memorandum, and so to split their shares, *e.g.* from £10 to £1 per share.

Examination candidates appear to be at a loss when confronted by an operation of this kind. The process of splitting shares is both costly and tiresome, but the financial entry involved is of the simplest, viz. a transfer from the old capital account to the new capital account.

Illustration.—Uprichards, Ltd., was registered with a nominal capital of 50,000 shares of £10 each, of which 30,000 shares were subscribed and fully paid up. The company was very successful, but found that the market for the shares was restricted owing to their high denomination. A resolution was passed on December 31, 19..., subdividing each £10 share into ten shares of £1 each. The old certificates were called in and exchanged for the new, and the necessary alterations were made in the Share Ledger. The only entry necessary in the financial books is as follows:—

8

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Ordinary Shares (£10) Account . . . Dr.		300,000	0	0			
	To Ordinary Shares (£1) Account . . .					300,000	0	0
	Being the conversion of the old ordinary share capital of 30,000 shares of £10 each, into new ordinary shares of £1 each as per special resolution, dated December 31, 19...							

EXAMINATION QUESTION.

On December 31, 19..., the North and South Colliery Company, Ltd., had Ordinary Share Capital, authorised and fully Subscribed, of £200,000, in shares of £10 each, and a General Reserve of £150,000. During 19... the capital was increased by £100,000, in new shares of £1 each; and the original shares were converted into shares of £1 each. Resolutions were duly passed, whereby £100,000 of the Reserve was distributed to the Ordinary Shareholders as bonus, and was applied in satisfaction of new shares issued to the shareholders at par. Set out the Journal entries and the accounts in full recording the foregoing transactions, and the information, in respect thereof, which should appear on the Balance Sheet of the company as on December 31, 19.... (*Chartered Accountants.*)

Solution.

14

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Ordinary Share Capital Account (£10 shares). Dr.	1	200,000	0	0			
	To Ordinary Share Capital (£1 shares) . .	3				200,000	0	0
	Being transfer of the former account to the new Share Capital (£1 shares) Account.							
" 31	Reserve Account . . . . . Dr.	5	100,000	0	0			
	To Bonus Dividend Account	7				100,000	0	0
	Being Bonus declared from Reserve as per resolution dated							
" 31	Bonus Dividend Account . . . . Dr.	7	100,000	0	0			
	To Ordinary Share Capital (£1 shares) Account .	9				100,000	0	0
	Being transfer of the former account in satisfaction of 100,000 shares of £1 each allotted as per resolution dated							

LEDGER.

1 ORDINARY SHARE CAPITAL (£10 SHARES) ACCOUNT. 1

Dr.		J.	£	s.	d.	Cr.			£	s.	d.
19 .. Dec. 31	To Ordinary Share Capital (£1 shares) Account	14	200,000	0	0	19... Dec. 31	By Balance . .	√	200,000	0	0

3 ORDINARY SHARE CAPITAL (£1 SHARES) ACCOUNT. 3

Dr.			£	s.	d.	Cr.		J.	£	s.	d.
						19... Dec. 31	By Ordinary Share Capital (£10 shares) Account	14	200,000	0	0
						" 31	" Bonus Dividend Account .	14	100,000	0	0
									£300,000	0	0

LEDGER—*continued.*

5 DR. RESERVE ACCOUNT. CR. 5

19...		J.	£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Bonus Dividend Account	14	100,000	0	0	Dec. 31	By Balance	√	150,000	0	0
„ 31	„ Balance carried down	√	50,000	0	0						
			£150,000	0	0				£150,000	0	0
						19.. Dec. 31	By Balance brought down	√	50,000	0	0

7 DR. BONUS DIVIDEND ACCOUNT. CR. 7

19...		J.	£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Ordinary Share Capital (£1 shares) Account	14	100,000	0	0	Dec. 31	By Reserve Account	14	100,000	0	0

North and South Colliery Company, Ltd.

BALANCE SHEET, DECEMBER 31, 19....

(LIABILITIES SIDE ONLY.)

	£	s.	d.	£	s.	d.
Capital:— *Nominal*: 300,000 Ordinary Shares of £1 each	300,000	0	0			
Issued: 300,000 Ordinary Shares of £1 each, fully paid				300,000	0	0
Reserve Account				50,000	0	0

Conversion of Shares into Stock.—The characteristics of stock, and the reasons for the conversion of shares into stock, were explained on pp. 306–307. "Notice must be given to the registrar within one month of the change" (S. 62 [*b*]). Certificates made out after the change will, of course, describe the holdings in question as stock. The company may, if it wishes, call in the old share certificates to be exchanged for stock certificates, but no very useful purpose is served, and in practice this is hardly ever done: the old share certificate will ordinarily be taken as evidence of ownership of the corresponding amount of stock, and stock exchanges will recognise it as such. On the other hand, in the (very much rarer) event of the company converting its stock back into numbered shares, it would become necessary to call in all the stock certificates for exchange, since no numbers would appear on them, and if new certificates were not issued difficulties as to title might arise. As has already been stated, commercial companies usually restrict transfers of stock to a round sum, £1 or £5, etc., but Government stocks can usually be transferred in fractional amounts, *e.g.* £101 19*s.* 6*d.*

Companies are under no obligation to convert the whole of their fully paid shares into stock. They may convert a portion only, the remainder being left as originally issued.

Illustration.—Uprichards, Ltd., decided to convert their 8% Preference Share Capital of £200,000 into 8% stock of similar amount. The resolution authorising this was passed on July 2, 19..., and due notice was sent to th Registrar. The old certificates were called in, new stock certificates wer issued, and the necessary alterations were made in the Share Ledger. Th only entry required in the financial books is as follows:—

8

JOURNAL.

		Dr.			Cr.		
19...		£	s.	d.	£	s.	d.
July 2	8% Preference Share Capital Account . . Dr.	200,000	0	0			
	To 8% Preference Stock Account . . .				200,000	0	0
	Being the conversion of 200,000 8% Preference Shares of £1 each into 8% Preference Stock as per special resolution passed this day.						

Alternatively, some accountants would simply alter the heading of the old account.

Interest Paid Out of Capital.—A limited company must pay interest to its creditors, *e.g.* on debentures, loans, etc., whether or not there are profits available. If profits are not available, the interest must be paid out of capital. It may not pay dividends out of capital, since that would amount to a return of capital, which is illegal, except as laid down by Statute. But in certain circumstances, a company may pay *interest* to its shareholders out of capital. Companies formed for the purpose of constructing works, or providing plant, which, during the long period of construction, will be unproductive of revenue, may pay interest on the paid-up capital raised for that purpose, and may capitalise that interest as part of the cost of construction, subject to the following conditions:—

(1) Such payments must be authorised by the Articles, or by special resolution.

(2) They must also be authorised by the Board of Trade.

(3) The Board of Trade may hold an enquiry at the company's expense prior to giving its assent, and may require security for the costs of the enquiry.

(4) The payments may be made only for the period determined by the Board, and may in no case extend beyond the close of the half-year next following the half-year during which the works were actually completed or the plant provided.

(5) The rate of interest must in no case exceed 4% per annum, or such other rate as may be prescribed from time to time by Order in Council.

(6) The payment of interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid.

(7) The accounts of the company must show the share capital on which, and the rate at which, interest has been paid out of capital during the period to which the accounts relate (Eighth Schedule, para. 2 [b]).

The student will realise that the principle of allowing interest to be paid and charged to capital in such cases is perfectly reasonable. Capital expenditure over a long period must perforce involve the question of interest as an additional cost. If the work were undertaken by an independent contractor he would, of course, take interest into account when preparing the estimates on which to base his tender. The final cost of construction work is made up of the cost of machinery, materials, labour, supervision, and establishment charges, *plus* interest on the capital employed, which, but for its employment in that way, would be invested in good securities, paying a reasonable rate of interest.

The allocation of the interest paid as between the various assets created needs careful consideration, and should be based as far as possible on the actual capital employed in constructing each particular asset.

Interest on sums paid in advance of calls can also be paid out of capital if no profits are available.

Balancing the Share Register.—Prior to the payment of a dividend, it is necessary to balance the Share Register. This is an important operation in the case of a large company whose shares are freely dealt in. The holdings entered on the lists as entitled to dividends must, of course, tally with the total issued capital of the company. The Share Ledgers having been closed (see p. 322) the first step is to check all transfers and to take out a "trial balance." Only the "folio" and "balance" of shares held by each member are extracted, and the sum of these balances must agree with the total of the share capital held. When several Registers are employed, it is usual to adapt the self-balancing principle to the Share Registers. For this purpose a *Transfer Postings Journal* is employed, as shown above.

TRANSFER POSTINGS JOURNAL.

Shares Transferred.	Transferees.				Transferors.			
	Registers.				Registers.			
	1	2	3	4	1	2	3	4
100		100					100	
75			75					75
30	50						50	
225	50	100	75				150	75

This book functions as a tabular journal, forming part of a system of self-balancing books, and can be conveniently kept on the "loose-leaf" principle.

Illustration.—Uprichards, Ltd., has an issued capital of 200,000 Ordinary Shares of £1 each. Four registers are kept containing particulars of holdings as under:—

	Shares.
No. 1 Register	56,000
No. 2 Register	44,000
No. 3 Register	85,000
No. 4 Register	15,000
	200,000

The above totals give us the starting-point for the Adjustment Account, which will be completed by adding or subtracting the totals shown in the Transfer Postings Journal as follows:—

ORDINARY SHARES ADJUSTMENT ACCOUNT.

	Registers. No. 1.	No. 2.	No. 3.	No. 4.	Totals.
Balances	56,000	44,000	55,000	15,000	170,000
Add Transferee's Postings	50	100	75		225
	56,050	44,100	55,075	15,000	170,225
Deduct Transferor's Postings			150	75	225
	56,050	44,100	54,925	14,925	170,000

The balances extracted from the four registers for the purpose of preparing the list of holdings entitled to dividend on the date when the registers were closed should agree with the Adjustment Account as prepared above. If they fail to agree, it will be seen in which register the error is located.

Increase of Capital.—The nominal capital of a company as fixed by its Memorandum cannot be increased except under the power conferred by S. 61, and then only if the Articles sanction an increase. If the Articles do not authorise an increase, they must be altered, by special resolution, to give the required power. Articles, almost invariably, take power to increase the registered capital, and frequently require a special resolution to exercise it, but, if the Articles so provide, an ordinary resolution will suffice. The matter cannot be left to the discretion of the directors, since S. 61 [2] provides that the power must be exercised by the company in general meeting. Increases of capital are quite frequent, and are usually made for the purpose of acquiring or absorbing other companies, or for purchasing similar businesses, or to provide additional working capital for development of the company's own business. Notice of any increase effected must be sent to the Registrar within fifteen days, and *ad valorem* duty must be paid on the new capital.

The book-keeping records for the issue of this increased capital are precisely similar to those required for an original issue of shares. Separate banking accounts and Cash Books should be opened for each class of share, if more than one class has been included in the increase. It is usual to open a temporary "New Ordinary Share Account," etc., to which the various Application, Allotment, and Call Moneys are credited. When the issue is complete, and the shares fully paid, the Account is closed by Transfer to the original Share Capital Account as follows:—

NEW ORDINARY SHARE CAPITAL ACCOUNT.

(ISSUE OF 100,000 NEW ORDINARY SHARES AUTHORISED BY SPECIAL RESOLUTION DATED JUNE 30, 19...)

DR.		P.L.	£	s.	d.		CR.		£	s.	d.
19 ..						19 ..					
Sept. 5	To Transfer to Ordinary Share Capital Account	56	100,000	0	0	July 1	By Application and Allotment Account	2	50,000	0	0
						Aug. 1	,, First Call Account	3	25,000	0	0
						Sept. 1	,, Final Call Account	5	25,000	0	0
			£100,000	0	0				£100,000	0	0

ORDINARY SHARE CAPITAL ACCOUNT.

Dr.					Cr.				
	£	s.	d.	19..			£	s.	d.
				July 1	By Balance . .	✓	150,000	0	0
				Sept. 5	,, Transfer from New Ordinary Share Capital Account .	P.L. 87	100,000	0	0
							£250,000	0	0

The various expenses connected with an increase of capital should be posted to an account headed "New Issue Expenses Account," and may, if so desired, be written off within a reasonable term, as was explained in connection with preliminary expenses. The balance of this account must appear under a separate heading on the Balance Sheet until written off (Eighth Schedule, para. 3).

Reduction of Capital.—It becomes advisable in certain circumstances to reduce the capital of a limited company. Trading losses may have been incurred, with the consequence that a heavy balance stands to the debit of Profit and Loss Account, and the declaration of dividends on the existing capital is made improbable, even should the tide of fortune begin to turn. Depreciation of assets may have occurred which render their book values untenable. In such, and similar, events, it is obvious that the company has become over-capitalised, and should adjust its capital to the altered circumstances, in order to attain some reasonable relation between its capital and assets, and so to readjust matters that dividends may be paid and the market value of its shares be re-established. We have already seen that supreme importance is attached by the Legislature to the obligation of a company to keep its capital intact. In the circumstances described above a private trader would meet the case by transfers to the debit of his Capital Account. But a limited company has no such power, and can reduce its capital only in statutory manner. Section 66 provides for a reduction of capital in any way, and in particular:—

(*a*) By extinguishing or reducing the liability on any of its shares not paid up.

(*b*) By cancelling paid-up capital which has been lost or is unrepresented by available assets.

(*c*) By returning to its shareholders capital proved to be in excess of the company's wants.

The majority of Articles give power to reduce capital in the three ways specified above. If Articles do not so empower, they must be altered by special resolution, so as to confer the power. To effect the reduction a special resolution must be passed, and this must be confirmed by the Court. Reductions of capital for reasons other than those given in (*b*) above are so rare that they need not be considered here.

The order of the Court when issued, together with a minute approved by the Court showing the capital as altered, viz., the amount, number of shares into which it is to be divided, the amount of each share, and the amount now deemed to be paid up thereon, must be filed with the Registrar and published as the Court may direct, and a copy must be added to every copy of the Memorandum and Articles. The Court may order that the words " and reduced " must be added to the name of the company, for so long as the Court directs.

Under a scheme of reduction the existing shares can be reduced in nominal value to any desired extent, but a member, past or present, shall not be liable, in respect of any share, to any call or contribution exceeding in amount the difference, if any, between the amount of the share as fixed by the minute approved by the Court and the amount paid, or the reduced amount, if any, which is deemed to have been paid, on the share, as the case may be (S. 70). (This must be read in conjunction with S. 22, which provides that no member shall be bound by any alteration made in the memorandum or articles which in any way increases his liability to contribute to the share capital, unless he agrees in writing to be bound thereby.) If, therefore, a company which is reducing its capital desires at the same time to raise additional funds, it must do so by a fresh issue which would, in these circumstances, probably take the form of Preference Shares, or Debentures. As an alternative, a new company consisting of the old shareholders could be formed, with readjusted capital rights, to purchase the property of the old company (S. 287).

The old share certificates must be called in to be cancelled, or indorsed, and the Register of Members must be amended to record the new conditions.

The method of recording capital reductions in book-keeping terms may be demonstrated by the following simple illustration :—

Illustration.—Blanks, Ltd., decided to reduce their capital of 100,000 shares of £1 each to 100,000 shares of 10s. each. It was further decided to utilise the reduction as follows : To write off Goodwill Account, £20,000 ; to reduce Machinery and Plant Account to £20,000 ; and to write off the debit balance of Profit and Loss Account, £20,000. At the date of the proposed reduction, the Balance Sheet of the Company was as follows :—

Blanks, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Issued Capital : 100,000 shares of £1 each, fully paid	100,000	0	0	Goodwill	20,000	0	0
Sundry Creditors	40,200	0	0	Machinery and Plant	30,000	0	0
				Sundry Assets	69,800	0	0
				Cash	400	0	0
				Profit and Loss Account	20,000	0	0
	£140,200	0	0		£140,000	0	0

The decisions arrived at as stated above may be expressed by the following Journal entry:—

JOURNAL. 8

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Share Capital Account . . . . . Dr.		50,000	0	0			
	To Reduction of Capital Account . . .					50,000	0	0
	Being the reduction of 100,000 shares of £1 each to shares of 10s. each.							
" 31	Reduction of Capital Account . . . Dr.		50,000	0	0			
	To Sundry Assets:—							
	Goodwill					20,000	0	0
	Machinery and Plant					10,000	0	0
	Profit and Loss Account					20,000	0	0
	Being the elimination or reduction of the above accounts.							

10 REDUCTION OF CAPITAL ACCOUNT. 10

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Sundry Assets:					19... Dec. 31	By Share Capital Account . .		50,000	0	0
	Goodwill . .		20,000	0	0						
	Machinery and Plant . .		10,000	0	0						
	Profit and Loss Account .		20,000	0	0						
			£50,000	0	0				£50,000	0	0

The remaining ledger accounts need not be illustrated. The readjusted Balance Sheet of the Company would appear as follows:—

Blanks, Ltd. (and Reduced).*

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Issued Capital:—				Machinery and Plant	20,000	0	0
100,000 shares of 10s. each, fully paid	50,000	0	0	Sundry Assets	69,800	0	0
Sundry Creditors	40,200	0	0	Cash	400	0	0
	£90,200	0	0		£90,200	0	0

If this Balance Sheet were to be laid before a General Meeting, the basis of valuation of the Fixed Assets would have to be shown, *e.g.* "at cost, less depreciation and amounts written off by order of Court."

The above illustration shows the basic principles on which reduction of Capital book-keeping entries are founded. Further details may now be introduced.

Illustration.—Rayon d'Or, Ltd., was registered with a nominal capital of £250,000, divided into 50,000 5% Cumulative Preference Shares, 100,000 7% Non-Cumulative Second Preference Shares, and 100,000 Ordinary Shares, all of £1 each. After several successful years, the company encountered three years of bad trade. On December 31, 19..., the Balance Sheet of the company was as shown on p. 425.

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* The words "and Reduced" need be added only where the Court so directs.

Rayon d'Or, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.	£	s.	d.		£	s.	d.
CAPITAL :—							Leasehold Factory	100,896	0	0
Nominal—							Patents Account	30,000	0	0
50,000 5% Cumulative 1st Preference Shares of £1 each	50,000	0	0				Machinery and Plant	52,785	0	0
100,000 7% Non-Cumulative 2nd Preference Shares of £1 each	100,000	0	0				Stock	38,898	0	0
100,000 Ordinary Shares of £1 each	100,000	0	0				Sundry Debtors	29,776	0	0
	£250,000	0	0				Debenture Issue Expenses Account	2,780	0	0
Issued—							Cash at Bank (Current Account)	1,784	0	0
50,000 5% Cumulative 1st Preference Shares of £1 each	50,000	0	0				Profit and Loss Account (Balance)	20,712	0	0
80,000 7% Non-Cumulative 2nd Preference Shares of £1 each	80,000	0	0							
80,000 Ordinary Shares of £1 each	80,000	0	0	210,000	0	0				
Debentures : 200 4½% Debentures of £100 each				20,000	0	0				
Sundry Creditors				32,869	0	0				
Bank Loan				11,762	0	0				
Reserve Account				3,000	0	0				
				£277,631	0	0		£277,631	0	0

The 5% First Preference shareholders declined to agree to any reduction of their shares on the ground that they held preferential rights both as to dividend (cumulative) and capital. The necessary meetings of the Second Preference and Ordinary shareholders were called, and a special resolution was passed on January 15, 19..., and embodied in an order of the Court dated March 10, 19..., as follows:—

> **Resolved** that the capital of Rayon d'Or, Ltd., be reduced as follows: The 80,000 7% Non-Cumulative Preference Shares of £1 each to be reduced to 80,000 shares of 15*s.* each fully paid, and the 80,000 Ordinary Shares of £1 each to be reduced to 80,000 shares of 5*s.* each fully paid, and that such reductions shall be effected by writing off capital which has been lost or is no longer represented by available assets.

By this scheme £80,000 was made available for writing off losses and depreciated assets, viz.:—

	£
Reduction of 7% Non-Cumulative Preference Shares	20,000
Reduction of Ordinary Shares	60,000
	£80,000

It was decided to utilise this sum as follows:—

	£
(*a*) To write off Patents Account	3,000
(*b*) To write off Debenture Issue Expenses Account . . .	2,780
(*c*) To write off the debit balance of Profit and Loss Account .	20,712
(*d*) To write £11,782 off the Stock	11,782
(*e*) To write £14,726 off Machinery and Plant	14,726
	£80,000

It was also decided to transfer the Reserve Account to the credit of Machinery and Plant Account in order further to reduce the book value of that asset.

The entries required for this scheme of reduction are as follows:—

46 JOURNAL.

			Dr.			Cr.		
19...			£	s.	d.	£	s.	d.
Mar. 10	7% 2nd Preference Share Capital Account . Dr.	3	20,000	0	0			
	To Reduction of Capital Account . . .	27				20,000	0	0
	Being 5*s.* per share on 80,000 shares of £1 each written off as per order of the Court, dated this day.							
,, 10	Ordinary Share Capital Account . . Dr.	5	60,000	0	0			
	To Reduction of Capital Account . . .	27				60,000	0	0
	Being 15*s.* per share on 80,000 shares of £1 each written off as per order of the Court, dated this day.							
,, 10	Reduction of Capital Account . . . Dr.	27	80,000	0	0			
	To Sundries:—							
	Patents Account	15				30,000	0	0
	Debenture Issue Expenses Account . .	23				2,780	0	0
	Profit and Loss Account	25				20,712	0	0
	Stock	19				11,782	0	0
	Machinery and Plant	17				14,726	0	0
	Being allocation of the amount available for the reduction of assets and losses under the above order.							
,, 10	Reserve Account . . . . . . Dr.	11	3,000	0	0			
	To Machinery and Plant Account . . .	17				3,000	0	0
	Being transfer of the former account.							

LEDGER.

1 5% Cumulative 1st Preference Share Capital Account. 1

Dr. Cr.

			£	s.	d.				£	s.	d.
						Dec. 31	By Balance . .	√	50,000	0	0

3 7% Non-Cumulative 2nd Preference Share Capital Account. 3

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Mar. 10	To Reduction of Capital Account .	J. 46	20,000	0	0	19... Dec. 31	By Balance . .	√	80,000	0	0
„ 10	„ Balance carried down . .	√	60,000	0	0						
			£80,000	0	0				£80,000	0	0
						19... Mar. 10	By Balance brought down . .	√	60,000	0	0

5 Ordinary Share Capital Account. 5

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Mar. 10	To Reduction of Capital Account .	J. 46	60,000	0	0	19... Dec. 31	By Balance . .	√	80,000	0	0
„ 10	„ Balance carried down . .	√	20,000	0	0						
			£80,000	0	0				£80,000	0	0
						19... Mar. 10	By Balance brought down . .	√	20,000	0	0

7 Sundry Creditors. 7

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Sundries . .	√	32,869	0	0

9 Bank Loan. 9

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Balance . .	√	11,762	0	0

11 Reserve Account. 11

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Mar. 10	To Machinery and Plant Account .	J. 46	3,000	0	0	19... Dec. 31	By Balance . .	√	3,000	0	0
			£3,000	0	0				£3,000	0	0

LEDGER—*continued.*

13 **LEASEHOLD FACTORY.** 13

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance . .	√	100,896	0	0						

15 **PATENTS ACCOUNT.** 15

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	√	30,000	0	0	19... Mar. 10	By Reduction of Capital Account	46	30,000	0	0
			£30,000	0	0				£30,000	0	0

17 **MACHINERY AND PLANT.** 17

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	√	52,785	0	0	19... Mar. 10	By Reduction of Capital Account	46	14,726	0	0
						" 10	" Reserve Account.	46	3,000	0	0
						" 10	" Balance carried down . .	√	35,059	0	0
			£52,785	0	0				£52,785	0	0
19... Mar. 10	To Balance brought down . .	√	35,059	0	0						

19 **STOCK.** 19

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	√	38,898	0	0	Mar. 10	By Reduction of Capital Account	46	11,782	0	0
						" 10	" Balance carried down . .	√	27,116	0	0
			£38,898	0	0				£38,898	0	0
19 .. Mar. 10	To Balance brought down . .	√	27,116	0	0						

21 **SUNDRY DEBTORS.** 21

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Sundries . .	√	29,776	0	0						

LEDGER—*continued.*

DEBENTURE ISSUE EXPENSES ACCOUNT.

23 Dr. | Cr. 23

			£	s.	d.			J.	£	s.	d.
19.. Dec. 31	To Balance . .	✓	2,780	0	0	Mar. 10	By Reduction of Capital Account	46	2,780	0	0
			£2,780	0	0				£2,780	0	0

PROFIT AND LOSS ACCOUNT.

25 Dr. | Cr. 25

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	✓	20,712	0	0	19... Mar. 10	By Reduction of Capital Account	46	20,712	0	0
			£20,712	0	0				£20,712	0	0

REDUCTION OF CAPITAL ACCOUNT.

27 Dr. | Cr. 27

		J.	£	s.	d.			J.	£	s.	d.
19... Mar. 10	To Sundry Asset Accounts . .	46	80,000	0	0	19... Mar. 10	By 2nd Preference Share Capital Account . .	46	20,000	0	0
						,, 10	,, Ordinary Share Capital Account	46	60,000	0	0
			£80,000	0	0				£80,000	0	0

4½% DEBENTURES.

29 Dr. | Cr. 29

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Balance . .	✓	20,000	0	0

CASH BOOK.

72 Dr. | Cr. 72

			£	s.	d.				£	s.	d.
19... ec. 31	To Balance . .	✓	1,784	0	0						

Note.—For Balance Sheet after reduction, *see* p. 430.

The first Balance Sheet prepared after such a reduction sometimes iscloses the details of the reduction by showing the original values nd the amount by which they are reduced. There is, however, no gal necessity to give such details, but if the Balance Sheet is to be id before a General Meeting, regard must be had to the provisions of ie Eighth Schedule, especially regarding comparative figures.

BALANCE SHEET, MARCH 10, 19...

(AFTER REDUCTION OF CAPITAL.)

				£	s.	d.		£	s.	d.
CAPITAL:—							Leasehold Factory	100,896	0	0
Nominal—	£	s.	d.				Machinery and Plant	35,059	0	0
50,000 5% Cumulative 1st Preference Shares of £1 each	50,000	0	0				Stock	27,116	0	0
100,000 7% Non-Cumulative Preference Shares of 15s. each	75,000	0	0				Sundry Debtors	20,776	0	0
100,000 Ordinary Shares of 5s. each	25,000	0	0				Cash at Bank	1,784	0	0
	£150,000	0	0							
Issued—										
50,000 5% Cumulative 1st Preference Shares of £1 each	50,000	0	0							
80,000 7% Non-Cumulative 2nd Preference Shares of 15s. each	60,000	0	0							
80,000 Ordinary Shares of 5s. each	20,000	0	0	130,000	0	0				
Debentures: 200 4½% Debentures of £100 each				20,000	0	0				
Sundry Creditors				32,869	0	0				
Bank Loan				11,762	0	0				
				£194,631	0	0		£194,631	0	0

See note to Balance Sheet on p. 424

EXAMINATION QUESTION.

The Directors of Fitzgeralds, Ltd., decide to reduce the company's capital of 120,000 shares of £1 each, fully paid, to 120,000 shares of 10*s.* each, fully paid.

Prior to the proposed reduction of capital the Balance Sheet of the company was as follows:—

BALANCE SHEET.

	£	s.	d.		£	s.	d.
Share Capital	120,000	0	0	Goodwill	40,000	0	0
Bank Overdraft	10,000	0	0	Freehold Factory	81,000	0	0
Sundry Creditors	52,250	0	0	Machinery and Plant	12,500	0	0
Premium on Shares Account	2,000	0	0	Patents	8,500	0	0
				Stock	11,000	0	0
				Sundry Debtors	10,800	0	0
				Cash	200	0	0
				Profit and Loss Account	20,250	0	0
	£184,250	0	0		£184,250	0	0

It was decided: (1) to eliminate the Premium on Shares Account; (2) to write off the debit balance of the Profit and Loss Account; and (3) to re-value the assets as follows: Goodwill, £20,000; Patents, nil; Stock, £10,000; and any balance remaining available to be used to write down the book value of the Freehold Factory.

Submit the entries necessary in order to carry these decisions into effect and give the Balance Sheet of the company as it would appear after the reduction of capital had been effected. (*London Chamber Commerce.*)

JOURNAL.

12

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
19.. Dec. 31	Share Capital Account . . . . Dr.	1	60,000	0	0			
	To Reduction of Capital Account	3				60,000	0	0
	Being reduction of 120,000 shares of £1 each to 10s. each.							
" 31	Premiums on Shares Account . . . Dr.	2	2,000	0	0			
	To Reduction of Capital Account	3				2,000	0	0
	Balance of former account transferred.							
" 31	Reduction of Capital Account . . . Dr.		62,000	0	0			
	To Sundries :—							
	Profit and Loss Account					20,250	0	0
	Goodwill					20,000	0	0
	Patents	5				8,500	0	0
	Stock					1,000	0	0
	Freehold Factory					12,250	0	0
	Being allocation of the amount available for the reduction of assets and losses.							

LEDGER.

SHARE CAPITAL ACCOUNT.

1 Dr. Cr. 1

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Reduction of Capital Account	12	60,000	0	0	19... Dec. 31	By Balance	√	120,000	0	0
" 31	" Balance carried down	√	60,000	0	0						
			£120,000	0	0				£120,000	0	0
						19.. Dec. 31	By Balance brought down	√	60,000	0	0

LEDGER—*continued.*

3 REDUCTION OF CAPITAL ACCOUNT. 3

Dr. Cr.

19..		J.	£	s.	d.	19..		J.	£	s.	d.
Dec. 31	To Sundry Assets	12	62,000	0	0	Dec. 31	By Premium on Shares Account	12	2,000	0	0
						,, 31	,, Share Capital Account	12	60,000	0	0
			£62,000	0	0				£62,000	0	0

5 GOODWILL. 5

Dr. Cr.

19..		J.	£	s.	d.	19..		J.	£	s.	d.
Dec. 31	To Balance	√	40,000	0	0	Dec. 31	By Reduction of Capital Account	12	20,000	0	0
						,, 31	,, Balance carried down	√	20,000	0	0
			£40,000	0	0				£40,000	0	0
19... Dec. 31	To Balance brought down	√	£20,000	0	0						

(The remaining Ledger accounts need not be reproduced here, as they are similar to the above.)

Return of Capital to Shareholders.—Owing to altered circumstances, companies occasionally find themselves possessed of a larger capital than they require. The redundant capital may have resulted because the company has curtailed its operations, *e.g.* abandoned its foreign trade, or be due to a particular piece of legislation. If such a condition should arise, Sections 66 and 67 authorise the return of that part of the capital no longer required, and the company may either, with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company (S. 66, 1 (*c*)). This power, however, can be exercised only provided the Articles originally, or as altered for the purpose by special resolution, sanction such a course, and by special resolution subsequently confirmed by the Court. Further, where the proposed reduction involves either diminution of liability in respect of unpaid share capital, or the repayment of any paid-up share capital, any creditor of the company may object to the reduction. The Court may then settle a list of the creditors, and if satisfied with respect to every creditor that either his consent to the reduction of capital has been obtained, or that his debt or claim has been discharged or has been secured, may make an order confirming the reduction on such terms and conditions as it thinks fit (SS. 67 and 68).

Illustration.—Blanks, Ltd., was registered with a capital of 100,000 shares of £1 each. Owing to the imposition of high tariffs by various foreign countries, their export department was closed down, and the original capital could no longer be employed profitably. It was therefore decided to reduce the 100,000 shares of £1 each to 100,000 shares of 15*s*. each, and to return 5*s*. per share to the shareholders. A special resolution was passed to give effect to this decision, no creditor of the company objected, and the Court confirmed the reduction of capital. The entries necessary are as follows:—

JOURNAL.

12

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Share Capital Account . . . . Dr. To Sundry Shareholders . . . . . Being 5*s.* per share returnable to shareholders on 100,000 shares of £1 each, now reduced to 100,000 shares of 15*s.* each.	2 3	25,000	0	0	 25,000	 0	 0

CASH BOOK.

1 Dr. 1 Cr.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Cash. Sundry Shareholders, 5*s.* per share on 100,000 shares .	3	25,000	0	0

LEDGER.

Share Capital Account.

2 Dr. 2 Cr.

		J.	£	s.	d.				£	s.	d.
19 .. Dec. 31	To Sundry Shareholders . .	12	25,000	0	0	19... Dec. 31	By Balance . .	√	100,000	0	0
" 31	" Balance carried down . .	√	75,000	0	0						
			£100,000	0	0				£100,000	0	0
						19... Dec. 31	By Balance brought down . .	√	75,000	0	0

Sundry Shareholders.

3 Dr. 3 Cr.

		C.B.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Cash . .	1	25,000	0	0	19... Dec. 31	By Share Capital Account . .	12	25,000	0	0

Suitable amendment of the Share Register is also necessary recording the alteration in the denomination of the shares.

EXAMINATION QUESTIONS.

1. A limited company issued £50,000 Ordinary Capital in £10 shares, payable £1 on application, £4 on allotment, and the balance two months later. The company also issued £50,000 in Debentures of £100 each, payable 10% on application and the balance on allotment. The whole was subscribed and allotted on January 10, 19... Give the necessary Journal entries to record the above. (*National Union Teachers.*)

2. Make the Journal entries necessary in order to record the undermentioned transaction: The Southern Cross Packing Company, Ltd., issued, on June 30, 19..., 100,000 Ordinary £1 shares at a premium of 5*s.* per share, payable on application. The shares applied for were payable as to 10*s.* per share on application and as to 15*s.* per share upon allotment. The issue was fully subscribed by the public. Allotment duly took place for the whole issue on July 15, 19... (*London Chamber Commerce.*)

3. Laurent Carie, Ltd., a newly formed Company, issued 50,000 Ordinary Shares of £1 each and 50,000 6% Preference Shares of £1 each. Of these, 51,650 Ordinary Shares were applied for, 50,000 of which were allotted; and 48,500 Preference Shares, all of which were allotted.

Briefly describe the procedure necessary in order to carry out the issue and allotment of these shares, and give rulings of any special books or papers you would recommend.

Both classes of shares were payable: 2*s.* 6*d.* per share on application, January 3, 19...; 5*s.* per share on allotment, January 5, 19...; 12*s.* 6*d.* per share, first and final call, January 31, 19... (*Royal Society Arts.*)

4. The Tulip Soap Company, Ltd., was formed on January 1, 19..., with a nominal capital of 60,000 shares of £1 each, divided into 15,000 5% Preference Shares and 45,000 Ordinary Shares. 8,000 Preference Shares were allotted and paid for in full on January 10. 35,000 Ordinary Shares were allotted on January 15, 5*s.* being paid on application and allotment. A final call was made on March 5, when all amounts were paid except the final call on 100 shares. On March 25, £7,000 was raised by the issue of 5% Debentures, the cost of the same, £380, being paid in cash on that day. On April 15 the company purchased the business of G. Gale, taking over the following assets: Plant, £5,000; Stock, £3,000; Sundry Debtors, £2,000, which were paid for by the allotment of 2,000 Preference Shares and 3,000 Ordinary Shares, fully paid, and the balance in cash.

Show Cash and Ledger accounts and Journal entries to record the above transactions and the Balance Sheet of the Company as at April 30, 19....

5. The West African Rubber Company, Ltd., which was registered with a capital of £100,000, divided into 1,000,000 shares of 2*s.* each, invited applications for its capital, payable 6*d.* per share on application, 1*s.* per share on allotment, and the remainder one month after allotment. On April 1, 19..., 1,200,000 shares were applied for, and the deposits thereon received. On April 6 following, applications for 800,000 shares were accepted in full, while applicants for the remaining 400,000 shares were allotted half the number they had respectively applied for. The balance due on allotment was in each case received on the following day, and the final instalment was received on May 6, 19... You are asked to show the record of the above transactions in the Company's Cash Book and Journal and in the following accounts in the Ledger: (*a*) Applications Account; (*b*) Allotment Account; (*c*) Call Account; (*d*) Share Capital Account. (*Chartered Institute Secretaries.*)

6. The Mosside Pumping Company, Ltd., was registered in 19... with a Nominal Capital of 500,000 shares of £1 each. During the same year 250,000 of these shares were issued and fully paid up.

The balance of the Share Capital was offered to the public in 19... at a premium of 5*s.* per share. Of these shares 200,000 were applied for and duly allotted, payable as to 7*s.* 6*d.* per share on application (including the premium) and 2*s.* 6*d.* per share one month after allotment. No further call was made during the year. The expenses of the second issue amounted to £1,025, of which amount £500 was written off during the year.

Show how the above transactions would appear in the Company's Balance Sheet as on December 31 last. (*Chartered Accountants.*)

7. Whiteheads, Ltd., issued new capital on February 28, 19..., consisting of 40,000 Ordinary Shares of £1 each, payable as to 5*s.* on application, 5*s.* on allotment, and 10*s.* one month after allotment. The shares were issued at a premium of 5*s.* per share, payable on allotment, and the issue was over-subscribed to the extent of 10,000 shares. Make the necessary Cash Book and Journal entries, the whole of the money having been duly received by the Company. (*Chartered Accountants.*)

8. Journalise the following transactions of a limited company:—

The company was registered on January 1, 19..., with a Nominal Capital of £120,000 divided into 120,000 shares of £1 each, of which 40,000 were issued as fully paid to the vendor as part purchase consideration, 40,000 offered for subscription to provide working capital, payable as to 5*s.* per share on application, 5*s.* per share on allotment, and the remainder in two calls of 5*s.* each; 40,000 shares to be held in reserve for future issue. The vendor also received £10,000 in 5% Debentures, being the balance of the purchase consideration. (*Chartered Accountants.*)

9. A limited company, with a Nominal Capital of £50,000 in 50,000 Ordinary shares of £1 each, was formed to acquire an existing business. Shares to the value of £10,000 were issued to the vendors as fully paid, and 20,000 shares were subscribed for by the public. During the first year 15*s.* per share was called up, being 5*s.* per share on application, 5*s.* per share on allotment, 2*s.* 6*d.* per share first call, and 2*s.* 6*d.* per share second call. At the end of the first year there had been paid up on the shares subscribed for by the public: on 15,000 shares the full amount called; on 3,000 shares 12*s.* 6*d.* per share; on 1,500 shares 10*s.* per share; on 500 shares 5*s.* per share.

You are required to give the entries necessary to record the Capital transactions in the books of the company, taking into consideration the fact that all shares upon which less than 10*s.* per share had been paid were forfeited by resolution of the Directors. You are also required to show how the Capital would appear in the Balance Sheet of the company at the end of the first year. (*Chartered Institute Secretaries.*)

10. The Denton Mining Company, Ltd., was registered on January 1, 19..., with a Nominal Capital of £150,000, to acquire the Daluth Tin mining claim from Prospectors, Ltd. The purchase price of the claim was agreed at £50,000, payable as follows: Cash, £10,000; Ordinary Shares, £30,000; Debentures, £10,000.

The Company offered 100,000 Ordinary Shares of £1 each for public subscription on January 3, 19..., at a premium of 5*s.* per share, payable as to 7*s.* 6*d.* per share (including the premium of 5*s.*) on application, 5*s.* per share on allotment, and the balance on February 15.

On January 10 the Directors went to allotment upon applications for 85,650 shares, all of which were allotted, and the allotment moneys duly paid on or before February 1, 19... The final call was also duly paid with the exception of the amount due upon a holding of 500 shares. The agreement with Prospectors, Ltd., was carried out on January 25.

Give the necessary entries to record these transactions, and show how they would appear in the Company's Balance Sheet. (*Chartered Institute Secretaries.*)

11. The Oriental Supplies Company, Ltd., made an issue of 50,000 Ordinary Shares of £1 each at a premium of 2*s.* per share, 2*s.* 6*d.* per share payable on application, 4*s.* 6*d.* (including the premium) on allotment, and 5*s.* on first call, due three months after allotment, and the balance as required.

The Application List was closed on March 25, 19..., when it appeared that applications had been received for 60,000 shares.

On March 31 the Directors met and allotted shares as follows: applicants for 40,000 shares in full; applicants for 15,000 shares, 10,000; applicants for 5,000 shares, nil, their application money being returned on April 1.

The whole of the amounts due on application and allotment were received by April 10.

The first call became due on June 30, 19..., and was all received by July 8, with the exception of the call due on 1,000 shares.

The call on these 1,000 shares not having been received, the shares were duly declared forfeited by the Directors on September 30, 19...

Make the necessary entries in the Cash Book and Journal of the Company to record the above transactions. (*Chartered Accountants.*)

12. Can shares be issued at: (*a*) a discount, (*b*) a premium? If so, how should the transactions be dealt with in the books of the company?

13. The Redesdale Trading Company, Ltd., had a total subscribed Capital of £100,000 in Ordinary Shares of £10 each, on which £7 10*s.* had been called up. A final call was made, and all amounts were paid except £25 due from W. Ford, who owned 10 shares. These shares were forfeited and re-issued at £9 per share for cash. Show the General Ledger Accounts in which the above transactions are recorded and the balances thereof as they would appear in the Balance Sheet of the Company.

14. One thousand shares of £1 each in the Allmetal Aircraft Company, Ltd., were allotted to Henry Brown, of Middlesbrough, ironmaster, on March 1, 19...

He paid 5*s.* per share on application, and 5*s.* per share on allotment. A first call of 5*s.* per share was made, payable on June 1, 19... This he failed to pay, and the Directors of the Company decided to forfeit his shares. Notice of the intention to forfeit was given on August 1, 19..., and as the call still remained unpaid the shares were duly forfeited on September 1, 19... In the meantime a second call of 5*s.* per share had been made, payable on September 1, 19...

On October 1, 19..., the forfeited shares were re-issued as fully paid to William Watts, of Corporation Street, Manchester, cotton merchant, at the price of 15*s.* per share.

Describe the usual course of procedure in forfeiting shares, and make the entries in the books of the company necessary to show the full effect of the above transaction. (*Chartered Accountants.*)

15. Sorrell & Son, Ltd., was registered as a limited liability company on October 1, 19..., with an Authorised Capital of £500,000. The company went to allotment on November 1, 19..., when 200,000 Ordinary Shares at £1 each were allotted at a premium of 2*s.* 6*d.* per share, payable 2*s.* 6*d.* on application, 5*s.* (including premium) on allotment, and the balance on May 1 next. All the allotment and call money was paid when due except in the case of one shareholder, who failed to pay the final call on 200 shares held by him. His shares were forfeited on June 1, 19... Show the necessary entries in the books of the company to record these transactions.

16. The Directors of a limited company forfeited 1,000 Ordinary Shares of £1 each owing to non-payment of the final call of 10*s.* per share. The shares were subsequently re-issued to another shareholder for a cash payment of 22*s.* 6*d.* per share.

(1) Are these proceedings *intra vires*?

(2) What steps should you take to enable you to arrive at a decision?

(3) How should the transactions be dealt with in the Balance Sheet which you are asked to certify? (*Chartered Accountants.*)

17. On February 11, 19..., the Directors of a limited company resolved that 60 shares of £1 each, issued to Howard Jones, should be forfeited for non-payment of the amounts payable on allotment and first call, viz. 7*s.* 6*d.* and 5*s.* respectively; the deposit on application, 2*s.* 6*d.*, had been paid. No further call was made. On March 25, 19..., they resolved that the said shares be issued to Robert Elmsley on payment by him of £40. Make the necessary entries in the company's books, including the Share Ledger. (*Chartered Accountants.*)

18. Prepare "Statutory Report" from the following figures: *Receipts:* On allotment of 50,000 shares of £10 each, £137,000. Proceeds sale of old building material removed from freehold, £1,742. Advanced on mortgage, £47,000. Received in respect of allotment of Debenture Stock (75% of £100,000), £75,000. *Payments:* Purchase of freehold, £205,000. Paid builders on account, £12,600. Paid for Stock in Bond, £24,350. Paid salaries, £247. Office and petty expenses, £147. Preliminary expenses to date, £2,471. (*Chartered Accountants.*)

19. Submit the Balance Sheet of a Company showing a large balance standing to the debit of Profit and Loss Account. Suggest a scheme for reduction of capital, and submit the Balance Sheet of the Company as it would appear when your proposed scheme of reduction of capital had been carried out.

20. How should the discount on the issue of Debentures be dealt with in the undermentioned circumstances? (*a*) Black, Ltd., issued 1,000 Debentures of £1,000 each at 95, repayable at par in ten years. (*b*) White, Ltd., issued £100,000 5% Perpetual Debenture Stock at 95. In each case the expenses of the issue, apart from discount, amounted to £3,500. (*London Chamber Commerce.*)

21. On January 1, Excelsa, Ltd., offered for subscription 500 4% Debentures of £100 each, repayable in five years at par. The price of issue was 98, payable as to £10 per Debenture on application, and the balance on March 1. Applications were received for 600 Debentures, and 500 were duly allotted on January 3. The underwriting and costs of the issue amounted to £500. Give the entries which these transactions would necessitate, and show how the issue would appear in the Balance Sheet of the Company as on December 31. (*London Chamber Commerce.*)

22. Malmaison, Ltd., issued £100,000 5% Debentures, in bonds of £100 each, on January 1, 19... The Debentures were issued at a premium of 5%, and were payable as to 20% on application, as to 30% (including the premium of 5%) on allotment (January 10), and the balance on January 25. Applications for 1,035 bonds were received.

Give the entries necessary to record the issue, and show how the above transactions would appear in the Balance Sheet of the Company. (*Chartered Institute Secretaries.*)

23. Describe the expenditure which, in your opinion, may be legitimately debited to "Preliminary Expenses Account" by a newly registered limited company.

State how you would deal with this expenditure in the books and published accounts of the company. (*London Chamber Commerce.*)

24. Describe the difference, if any, in the book-keeping records of a dividend paid: (*a*) Free of Income Tax; (*b*) Less Income Tax. (*Royal Society Arts.*)

25. The Directors of a limited company, with a fully paid Capital of 100,000 Ordinary Shares of £1 each, decided to pay an interim dividend of 10%, *less tax*, as on July 1.

Give the entries necessary to record the payment of the dividend. (*London Chamber Commerce.*)

26. Explain the functions and advantages of a "Dividend Book" as employed by limited companies.

Submit a suitable ruling for a book of this nature, and make three specimen entries therein. (*Royal Society Arts.*)

27. The Directors of the Stanfram Company, Ltd. (Capital authorised, subscribed and paid up, £50,000), at the end of their first year's trading, decide to recommend the payment of a dividend of 5%, and request you to advise as to the formalities incidental to the payment of the dividend. (*a*) State your recommendations; and (*b*) draft rulings for a *pro-forma* Dividend List. (*Incorporated Accountants.*)

28. A company is desirous of reducing its Capital. State shortly the steps that must be taken to effect its purpose where the Articles do not contain a clause empowering the company to make any such reduction. For what purpose is a reduction of Capital usually required? (*Incorporated Accountants.*)

29. Prepare the imaginary Balance Sheet of a company which has sustained considerable trading losses and depreciation of capital assets.

Assume that it has been decided to reduce the capital of the company by converting the fully paid £1 shares into shares of 10*s*. each, and redraft the Balance Sheet, showing the position after the reduction of capital has been duly carried out. (*Royal Society Arts.*)

30. In what cases and subject to what conditions is a company entitled to pay interest out of Capital? (*Chartered Institute Secretaries.*)

31. A successful Rubber Plantation Company found that its £5 shares rose to such a premium that the market became restricted. A special resolution was therefore duly passed dividing the Company's 10,000 Ordinary Shares of £5 each into 200,000 shares of 5*s*. each.

Show the entries which are necessary in order to give effect to the above resolution. (*Royal Society Arts.*)

32. The prospectus of Partington, Ltd., was publicly advertised on January 21, with the following loan and share issues: *Debentures*: 1,000 4% debentures of £100 each, the whole of which were offered and fully subscribed and paid up. *Preference Shares*: 20,000 6% Preference Shares of £5 each, the whole of which were offered and fully subscribed and paid up. *Ordinary Shares*: Nominal, 30,000 Shares of £5 each, of which 10,000 shares were issued as fully paid to the vendors in part payment of the purchase price of the business. Of the remaining 20,000 shares the public subscribed for 15,000 shares, the whole of which were, in due course, fully paid up, with the exception of the last call of £2 per share on 500 shares, which were subsequently forfeited by resolution of the Directors.

Pass the necessary entries through the Company's books to record these transactions, and state how they should appear in the Balance Sheet. (*London Chamber Commerce.*)

33. What are "preliminary expenses," and how are they dealt with by limited companies? To what extent (if any) are these expenses allowed by the Income Tax authorities as a charge against revenue? (*London Chamber Commerce.*)

34. The Annual Accounts of Ravary's, Ltd., showed a balance to the credit of Profit and Loss Account of £5,950, as on December 31, 19... The Nominal Capital of the Company consisted of 10,000 shares of £1 each, all of which had been subscribed and fully paid up.

At the annual meeting in February 19... it was decided: (*a*) To increase the Nominal Capital of the Company to £15,000 by the issue of 5,000 6% Preference Shares of £1 each. (*b*) To pay a dividend for the year 19... of 55%, 50% to be discharged by the issue of fully paid Preference Shares at par, and the balance, 5%, to be paid in cash.

Give the entries necessary to record these transactions. (*Royal Society Arts.*)

35. The accounts of Pain and Peters, Ltd., on December 31, 19..., showed a balance to the credit of Profit and Loss Account of £5,870. The Company was a private one, with a Nominal Capital of £15,000 in shares of £1 each, 10,000 of which were subscribed and fully paid up. These were held as follows: A, 4,000; B, 4,000; C, 1,000; D, 1,000. At the annual general meeting of the Company, at which all the shareholders were present, it was unanimously decided as follows:—

(1) To increase the Nominal Capital of the Company to £25,000, the additional £10,000 to consist of 10,000 6% Cumulative Preference Shares of £1 each.

(2) To pay a dividend for 19... of 50%, of which 20% was to be paid in cash and 30% by the issue of Preference Shares at par, treated as fully paid.

Make the Journal entries necessary to give effect to the above resolutions. (*Chartered Accountants.*)

36. What do you understand by "Debentures issued at a discount"? How would you show such Debentures in the Balance Sheet of a company? Give an example. (*London Chamber Commerce.*)

37. The Directors of the Argonaut Company, Ltd., issue £250,000 4% Debenture Stock at the price of 90. How should the discount be dealt with in the Company's Balance Sheets from year to year? (*Chartered Accountants.*)

38. A company issues £100,000 Debenture Stock at 90%, and pays 2% for underwriting it. How should the transactions show in the company's books? (*Chartered Accountants.*)

39. The Balance Sheet of the Lomax Company was composed of the following items: Paid-up Capital, £10,000; Debentures, £6,000; Cash, £11,000; Debtors, £4,000; Creditors, £3,000; Stock, £6,000; Premises, £5,000; Balance of Profit, £7,000. Instead of declaring a dividend, it was decided to exercise the option of paying off the whole of the debentures at a premium of 3%. Give the entries in the various Ledger accounts affected, and draw up a Balance Sheet showing the new position. (*National Union Teachers.*)

40. Sudemeyer, Ltd., issued £100,000 5% Debentures, in bonds of £100 each on January 1, 19... The Debentures were issued at a premium of 5%, and were payable as to 20% on application, as to 30% (including the premium of 5%) on allotment (January 10), and the balance on January 25. Applications for 1,035 bonds were received.

Give the entries necessary to record the issue, and show how the above transactions would appear in the Balance Sheet of the Company. (*Chartered Institute Secretaries.*)

41. A company made an issue of £100,000 Debenture Stock, secured by trust deed on all the fixed and floating assets of the company. Of this amount £50,000 was subscribed at a premium of 2%, £30,000 was subscribed at par, and £20,000 was issued to the company's bankers by way of collateral security for a loan of

£15,000. Give the entries which should appear in the company's Balance Sheet to record these transactions. (*Chartered Accountants.*)

42. A company has a Capital of £100,000 in Ordinary Shares of £1 each (fully paid up) and a debit balance on Profit and Loss Account of £50,000. It is desired to reduce the shares to 10*s*. each, in order to wipe off the debit balance. State what steps must be taken to carry out the scheme, and, assuming that to have been done, show the entries that would have to be made in the books. (*Chartered Institute Secretaries.*)

43. A limited company with a fully paid capital consisting of 200,000 Ordinary Shares of £1 each has traded unsuccessfully, with the result that the debit balance of the Profit and Loss Account now amounts to £68,585. It is decided, subject to confirmation by the Court, to reconstruct the company, and to reduce the £1 shares to shares of 10*s*. each fully paid. The balance of the Capital written off, after dealing with the Profit and Loss Account, is to be utilised in reducing the book value of assets of a wasting nature. Submit a *pro forma* Balance Sheet on the basis of the Capital and Profit and Loss figures above, and submit the entire procedure necessary to carry out the proposed reduction of Capital. (*Chartered Accountants.*)

44. How is a reduction of a company's Capital ordinarily effected? State particularly what steps are necessary where it is proposed: (*a*) to return capital to the shareholders; (*b*) to write off Capital which has been lost; (*c*) to cancel shares which have not been taken up.

45. A limited company is formed to purchase an existing business with a nominal capital of £200,000, one-half in Ordinary and one-half in 5% Preference Shares of £1 each. 60,000 of the Ordinary Shares are issued at a premium of 5*s*. per share, the Preference Shares being all issued at par; 5*s*. per share being payable on application, and 10*s*. on allotment in each case. £20,000 6% Debentures are underwritten at 98%. On account of the purchase money of £54,000 a sum of £8,000 is paid in discharge of the liabilities of the vendor, and the following assets taken over: Stock-in-trade, £12,000; Book Debts, £20,000; Machinery and Plant, £6,000.

Journalise the entries necessary for recording the purchase in the books of the company. (*Incorporated Accountants.*)

CHAPTER XII

LIMITED COMPANIES—*Continued*

COMPANY ACCOUNTANCY—*Continued.*

[*Note.*—All references are to the Companies Act, 1948, unless otherwise stated.]

Purchase of a Business.—When a company is formed for the purchase of the business of a going concern, the first duty of the book-keeper is to make himself acquainted with the terms of the contract with the vendors, or the promoting syndicate, as the case may be. The purchase price will usually consist of cash and fully paid shares in agreed proportions. The greater the proportion taken in shares, the greater will be the public confidence in the venture.

The assets taken over will usually include a named sum for goodwill, though sometimes a round sum is fixed for the whole undertaking, including goodwill. In the latter case the amount payable for goodwill is represented by the excess of the purchase price over the value of the net assets required (*i.e.* over the tangible assets acquired, minus the liabilities assumed).

The last Balance Sheet of the vendor's business (with or without adjustments) usually forms the basis of the purchase contract. When the purchasing company assumes the liabilities, the vendor usually guarantees that they shall not exceed the Balance Sheet figures; frequently also he guarantees the book debts. In such cases the book-keeper must make any adjustments that may prove necessary, the vendor's account being debited or credited as occasion requires.

Procedure to Record Purchase of a Business.

(*a*) Open a Purchase Account and debit it with the agreed purchase price of the business and credit the vendor with the like amount.

(*b*) Open an account for each asset acquired (including goodwill) and debit the respective book values to these accounts. Credit Purchase Account with the like amounts in one total.

(*c*) Open accounts for the liabilities assumed and credit these accounts with their respective balances, as shown in the Balance Sheet. Debit Purchase Account with the like amounts in one total.

(*d*) If the vendor takes shares in part payment of the purchase price, credit Share Capital Account (or Debenture Account, if debentures are issued), in part payment, with the issued value of the shares (or debentures), and debit the vendor with a like amount.

(*e*) The entries recording the balance (if any) of the shares or debentures issued will be similar to those already fully described (see p. 352).

(*f*) Debit the Cash Book with the balance taken over, and any receipts on Share and Debenture Account, and credit all payments made to the vendor, or in payment of expenses.

Illustration 1.—Testouts, Ltd., was registered with a nominal capital of £200,000, divided into 100,000 Ordinary Shares of £1 each, and 100,000 7% Preference Shares of £1 each. A contract was entered into with Hugh Dickson agreeing to purchase his established business for the sum of £125,000. The purchase price was to be satisfied by the issue of 30,000 fully paid Ordinary Shares of £1 each, taken as representing 25*s.* per share; 50,000 fully paid 7% Preference Shares of £1 each; and the balance in cash. The company was to pay the liabilities, which the vendor guaranteed should not exceed the Balance Sheet figure. The vendor also guaranteed that the book debts should not realise less than £18,980. 25,000 Ordinary Shares at 25*s.* per share and 25,000 7% Preference Shares of £1 each were issued to the public, and fully paid up as on February 1, 19.... The Balance Sheet of Hugh Dickson, as on the date of purchase, was as follows:—

BALANCE SHEET, DECEMBER 31, 19...

	£	*s.*	*d.*		£	*s.*	*d.*
Capital (H. Dickson) . .	100,000	0	0	Freehold Premises. . .	48,762	0	0
Sundry Creditors . . .	12,413	0	0	Machinery and Plant . .	37,412	0	0
Bills Payable	12,000	0	0	Furniture and Fittings . .	897	0	0
				Sundry Debtors . .	18,980	0	0
				Stock	15,600	0	0
				Cash at Bank . . .	2,762	0	0
	£124,413	0	0		£124,413	0	0

The book debts realised £18,400, and a further liability (omitted from the Balance Sheet) amounting to £150 was paid. The preliminary expenses of the new company amounted to £3,850.

II **CASH BOOK.** II

Dr.		J.	£	*s.*	*d.*		Cr.		£	*s.*	*d.*
19... Dec. 31	To Purchase Account	12	2,762	0	0	19... Dec. 31	By Preliminary Expenses . .	31	3,850	0	0
" 31	" Sundry Shareholders :— 25,000 Ordinary Shares at 25*s.* .	28	31,250	0	0	" 31	" Sundry Creditors	13	12,413	0	0
	25,000 7% Preference Shares at £1 each . .	30	25,000	0	0	" 31	" Bills Payable .	15	12,000	0	0
" 31	" Cash (Sundry Debtors) . .	8	18,400	0	0	" 31	" Vendor, Balance due to him .		36,770	0	0
						" 31	" Sundry Creditors (omitted from Balance Sheet) .	13	150	0	0
						" 31	Balance carried down . .	√	12,229	0	0
			£77,412	0	0				£77,412	0	0
19... ec. 31	To Balance brought down . .	√	12,229	0	0						

JOURNAL.

12

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Sundry Assets :— Dr.							
	Freehold Premises	1	48,762	0	0			
	Machinery and Plant	3	37,412	0	0			
	Furniture and Fittings	5	897	0	0			
	Sundry Debtors	7	18,980	0	0			
	Stock	9	15,600	0	0			
	Cash	C.B. 11	2,762	0	0			
	To Purchase of Business Account	17				124,413	0	0
	Being the assets taken over by the Company as per contract dated December 18, 19...							
" 31	Purchase of Business Account Dr.	17	24,413	0	0			
	To Sundries :—							
	Sundry Creditors	13				12,413	0	0
	Bills Payable	15				12,000	0	0
	Being liabilities assumed by the Company as per contract dated December 18, 19...							
" 31	Purchase of Business Account Dr.	17	125,000	0	0			
	To Vendor	19				125,000	0	0
	Being agreed purchase price of the business as per contract dated December 18, 19...							
" 31	Vendor Dr.	19	87,500	0	0			
	To Sundries :—							
	Ordinary Share Capital Account	21				30,000	0	0
	Ordinary Shares Premiums Account	23				7,500	0	0
	7% Preference Capital Account	25				50,000	0	0
	Being allotment of 30,000 Ordinary Shares at 25*s.* per share, and 50,000 7% Preference Shares of £1 each, both fully paid as per contract for sale.							
Feb. 12	Vendor Dr.	19	730	0	0			
	To Sundry Debtors	7				580	0	0
	" Sundry Creditors	13				150	0	0
	Being amounts necessary to make up amounts guaranteed as per contract for sale.							
" 12	Ordinary Shareholders Dr.	27	31,250	0	0			
	To Ordinary Share Capital Account	21				25,000	0	0
	" Ordinary Share Premiums Account	23				6,250	0	0
	For application, allotment, and call moneys on 25,000 Ordinary Shares issued at 25*s.* per share.							
" 12	7% Preference Shareholders Dr.	29	25,000	0	0			
	To 7% Preference Share Capital Account	25				25,000	0	0
	For application, allotment, and call moneys on 25,000 7% Preference Shares of £1 each.							
" 12	Goodwill Account Dr.	33	25,000	0	0			
	To Purchase of Business Account	17				25,000	0	0
	Being transfer of balance representing Goodwill.							

LEDGER.

FREEHOLD PREMISES.

1 Dr. Cr. 1

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Purchase Account	12	48,762	0	0						

MACHINERY AND PLANT.

3 Dr. Cr. 3

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Purchase Account	12	37,412	0	0						

LEDGER—*continued.*

5 Furniture and Fittings. 5

Dr. Cr.

19...		J.	£	s.	d.				£	s.	d.
Dec. 31	To Purchase Account	12	897	0	0						

7 Sundry Debtors. 7

Dr. Cr.

19...		J.	£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Purchase Account	12	18,980	0	0	Dec. 31	By Vendor . .	12	580	0	0
						„ 31	„ Cash . .	C.B. 11	18,400	0	0
			£18,980	0	0				£18,980	0	0

9 Stock. 9

Dr. Cr.

19...		J.	£	s.	d.				£	s.	d.
Dec. 31	To Purchase Account	12	15,600	0	0						

13 Sundry Creditors. 13

Dr. Cr.

19...		C.B.	£	s.	d.	19...			£	s.	d.
Dec. 31	To Cash . .	12	12,413	0	0	Dec. 31	By Balance . .	✓	12,413	0	0
„ 31	„ Cash . .	✓	510	0	0	„ 31	„ Vendor . .	J.	150	0	0
			£12,563	0	0				£12,563	0	0

15 Bills Payable. 15

Dr. Cr.

19...		C.B.	£	s.	d.	19...			£	s.	d.
Dec. 31	To Cash . .	12	12,000	0	0	Dec. 31	By Balance . .	✓	12,000	0	0
			£12,000	0	0				£12,000	0	0

17 Purchase of Business Account. 17

Dr. Cr.

19...		J.	£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Sundry Liabilities .	12	24,413	0	0	Dec. 31	By Sundry Assets .	12	124,413	0	0
„ 31	„ Purchase Price .	12	125,000	0	0	„ 31	„ Goodwill Account . .	12	25,000	0	0
			£149,413	0	0				£149,413	0	0

LEDGER—*continued.*

19 VENDOR'S ACCOUNT. 19

Dr. Cr.

19...		J.	£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Ordinary and Preference Share Capital Accounts	12	87,500	0	0	Dec. 31	By Purchase of Business Account .	12	125,000	0	0
„ 31	„ Adjustment of Sundry Debtors and Creditors .	12	730	0	0						
„ 31	„ Cash . .	C.B. 12	36,770	0	0						
			£125,000	0	0				£125,000	0	0

21 ORDINARY SHARE CAPITAL ACCOUNT. 21

Dr. Cr.

			£	s.	d.	19...		J.	£	s.	d.
						Dec. 31	By Vendor . .	12	30,000	0	0
						„ 31	„ Sundry Shareholders . .	12	25,000	0	0
									£55,000	0	0

23 ORDINARY SHARE PREMIUMS ACCOUNT. 23

Dr. Cr.

			£	s.	d.	19...		J.	£	s.	d.
						Dec. 31	By Vendor . .	12	7,500	0	0
						„ 31	„ Sundry Shareholders . .	12	6,250	0	0
									£13,750	0	0

25 7% PREFERENCE SHARE CAPITAL ACCOUNT. 25

Dr. Cr.

			£	s.	d.	19...		J.	£	s.	d.
						Dec. 31	By Vendor . .	12	50,000	0	0
						„ 31	„ Sundry Shareholders . .	12	25,000	0	0
									£75,000	0	0

27 ORDINARY SHAREHOLDERS. 27

Dr. Cr.

19...		J.	£	s.	d.	19...		C.B.	£	s.	d.
Dec. 31	To Ordinary Share Capital and Premiums Accounts	12	31,250	0	0	Dec. 31	By Cash . .	11	31,250	0	0

29 7% PREFERENCE SHAREHOLDERS. 29

Dr. Cr.

19...		J.	£	s.	d.	19...		C.B.	£	s.	d.
Dec. 31	To 7% Preference Share Capital Account . .	12	25,000	0	0	Dec. 31	By Cash . .	11	25,000	0	0

LEDGER—*continued.*

31 PRELIMINARY EXPENSES ACCOUNT. 31

Dr. | Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Cash . . .	C.B. 12	3,850	0	0						

33 GOODWILL ACCOUNT. 33

Dr. | Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Purchase of Business Account .	J. 12	25,000	0	0						

Testouts, Ltd.

BALANCE SHEET, JANUARY 1, 19...

		£	s.	d.		£	s.	d.
Capital:—					Freehold Premises . .	48,762	0	0
Nominal—					Goodwill	25,000	0	0
100,000 Ordinary Shares of £1 each £100,000					Machinery and Plant . .	37,412	0	0
100,000 7% Preference Shares of £1 each . .	100,000				Furniture and Fittings .	897	0	0
	£200,000				Stock	15,600	0	0
Issued—					Cash at Bank . . .	12,229	0	0
55,000 Ordinary Shares of £1 each £55,000					Preliminary Expenses Account	3,850	0	0
75,000 7% Preference Shares of £1 each . .	75,000							
		130,000	0	0				
Ordinary Shares Premiums Account		13,750	0	0				
		£143,750	0	0		£143,750	0	0

Note —As this Balance Sheet is not to be laid before a General Meeting, the basis of valuation of fixed assets, etc., need not be stated.

Illustration 2.—Chatenays, Ltd., was registered with a nominal capital of £200,000, consisting of 200,000 Ordinary Shares of £1 each. A contract was entered into with G. Dickson to purchase his established business as on December 31, 19..., for the sum of £60,000, to be satisfied by the issue as fully paid of 25,000 Ordinary Shares taken at 25*s.* per share and the balance in cash.

In addition to the shares issued as fully paid as above, 60,000 shares were offered on January 5 to the public for subscription at 25*s.* per share, payable as follows: On application, 5*s.*; on allotment, 10*s.* (including the premium of 5*s.*); and on first and final call (March 5), 10*s.* per share. The whole issue was underwritten for a commission of 2½%, and an overriding commission of 1%, and a brokerage of 3*d.* per share was offered to stockbrokers and others for placing shares. The public applied for 65,000 shares. The Directors went to allotment on January 10, on which day Allotment Letters and Letters of Regret were posted.

Duty, legal charges, and other preliminary expenses amounted to £4,750. All moneys due on the shares were paid on or before March 7, except the final call of 10*s.* per share on 500 shares which remained unpaid. 3,200 shares were allotted on application forms bearing the stamp of stockbrokers.

On March 3, fifty 5% Debentures of £100 each were issued at 98½, and were fully subscribed and paid up. The expenses of the issue amounted to £426.

You are required to prepare the following:—

(1) Opening Journal entries;
(2) Cash Book;
(3) Ledger Accounts;
(4) Trial Balance; and
(5) Balance Sheet of the new Company.

JOURNAL.

9

			Dr. £	s.	d.	Cr. £	s.	d.
19... Jan. 1	Sundry Assets (net) . . . . . . Dr.	25	60,000	0	0			
	To G. Dickson	27				60,000	0	0
	Being purchase price of the Assets acquired as per Contract for Sale.							
" 1	G. Dickson . . . . Dr.	27	60,000	0	0			
	To Ordinary Share Capital Account . . .	1				25,000	0	0
	" Ordinary Share Premiums Account . .	3				6,250	0	0
	" Cash	C.B. 5				28,750	0	0
	Being 25,000 Ordinary Shares (taken at 25*s.*) and Cash in discharge of purchase consideration as per Contract for Sale.							
" 10	Application and Allotment Account . . Dr.	5	45,000	0	0			
	To Ordinary Share Capital Account . . .	1				30,000	0	0
	" Ordinary Share Premiums Account . .	3				15,000	0	0
	Being amounts payable on 60,000 shares allotted by Directors to the public this day.							
Mar. 3	Sundry Debenture Holders . . . . Dr.	15	4,925	0	0			
	Debenture Discount Account . . . . Dr.	13	75	0	0			
	To 5% Debentures	11				5,000	0	0
	Being amount due and discount on 50 £100 Debentures issued this day at 98½.							
" 5	First and Final Call Account . . . Dr.	7	30,000	0	0			
	To Ordinary Share Capital Account . . .	1				30,000	0	0
	Being Call due this day on 60,000 shares.							
" 7	Calls in Arrear . . . . Dr.	9	250	0	0			
	To First and Final Call Account . . .	7				250	0	0
	Being Call of 10*s.* per share on 500 shares unpaid.							

LEDGER.

1 ORDINARY SHARE CAPITAL ACCOUNT. 1

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
						19... Jan. 1	By G. Dickson .	9	25,000	0	0
						" 10	" Application and Allotment .	9	30,000	0	0
						Mar. 5	" First and Final Call. . .	9	30,000	0	0
									£85,000	0	0

3 ORDINARY SHARE PREMIUMS ACCOUNT. 3

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
						19... Jan. 1	By G. Dickson .	9	6,250	0	0
						" 10	" Application and Allotment .	9	15,000	0	0
									£21,250	0	0

LEDGER—*continued.*

5

APPLICATION AND ALLOTMENT ACCOUNT.

5

Dr. Cr.

19...		J.	£	s.	d.	19...		C.B.	£	s.	d.
Jan. 10	To Ordinary Share Capital Account.	9	30,000	0	0	Jan. 5	By Cash	5	45,000	0	0
" 10	" Ordinary Share Premiums Account	9	15,000	0	0						
			£45,000	0	0				£45,000	0	0

7

FIRST AND FINAL CALL ACCOUNT.

7

Dr. Cr.

19...		J.	£	s.	d.	19...		C.B.	£	s.	d.
Mar. 5	To Ordinary Share Capital Account	9	30,000	0	0	Mar. 5	By Cash	5	29,750	0	0
						" 7	" Calls in Arrear	J.9	250	0	0
			£30,000	0	0				£30,000	0	0

9

CALLS IN ARREAR.

9

Dr. Cr.

19...		J.	£	s.	d.				£	s.	d.
Mar. 7	To First and Final Call Account	9	250	0	0						

11

5% DEBENTURES ACCOUNT.

11

Dr. Cr.

			£	s.	d.	19...		J.	£	s.	d.
						Mar. 3	By Sundry Debenture Holders	9	4,925	0	0
						" 3	" Debenture Discount	9	75	0	0
									£5,000	0	0

13

DEBENTURE DISCOUNT ACCOUNT.

13

Dr. Cr.

19...		J.	£	s.	d.				£	s.	d.
Mar. 3	To 5% Debentures	9	75	0	0						

15

SUNDRY DEBENTURE HOLDERS.

15

Dr. Cr.

19...		J.	£	s.	d.	19...		C.B.	£	s.	d.
Mar. 3	To 5% Debentures	9	4,925	0	0	Mar. 3	By Cash	5	4,925	0	0

17

UNDERWRITING COMMISSION, ETC.

17

Dr. Cr.

19...		C.B.	£	s.	d.				£	s.	d.
Jan. 1	To Cash	5	2,100	0	0						

LEDGER—*continued.*

19 **PRELIMINARY AND FORMATION EXPENSES.** 19

Dr.									Cr.		
			£	s.	d.				£	s.	d.
19... Jan. 1	To Cash . . .	C.B. 5	4,750	0	0						

21 **DEBENTURE ISSUE EXPENSES ACCOUNT.** 21

Dr.									Cr.		
			£	s.	d.				£	s.	d.
19... Mar. 7	To Cash . . .	C.B. 5	426	0	0						

23 **BROKERAGE.** 23

Dr.									Cr.		
			£	s.	d.				£	s.	d.
19... Jan. 1	To Cash . . .	C.B. 5	40	0	0						

25 **SUNDRY ASSETS.** 25

Dr.									Cr.		
			£	s.	d.				£	s.	d.
19... Jan. 1	To G. Dickson . .	J. 9	60,000	0	0						

27 **G. DICKSON, VENDOR.** 27

Dr.									Cr.		
			£	s.	d.				£	s.	d.
19... Jan. 1	To Ordinary Shares .	J. 9	31,250	0	0	19... Jan. 1	By Sundry Assets .	J. 9	60,000	0	0
„ 1	„ Cash . . .	C.B. 5	28,750	0	0						
			£60,000	0	0				£60,000	0	0

TRIAL BALANCE, MARCH 7, 19...

		Dr.			Cr.		
		£	s.	d.	£	s.	d.
Ordinary Share Capital Account	1				85,000	0	0
Ordinary Share Premiums Account	3				21,250	0	0
Calls in Arrear	9	250	0	0			
5% Debentures Account	11				5,000	0	0
5% Debenture Discount Account	13	75	0	0			
Underwriting Commission	17	2,100	0	0			
Preliminary and Formation Expenses	19	4,750	0	0			
Debenture Issue Expenses Account	21	426	0	0			
Brokerage	23	40	0	0			
Sundry Assets	25	60,000	0	0			
Cash in hand	C.B. 5	43,609	0	0			
		£111,250	0	0	£111,250	0	0

5 Dr. CASH BOOK. Cr. 5

19...			£	s.	d.	19...			£	s.	d.
Jan. 25	To Sundry Shareholders (Application and Allotment)	5	45,000	0	0	Jan. 1	By G. Dickson (Balance of Purchase Price)	27	28,750	0	0
Mar. 5	" Sundry Debenture Holders	15	4,925	0	0	" 1	" Underwriting Commission	17	2,100	0	0
" 5	" Sundry Shareholders (First and Final Call)	7	29,750	0	0	" 1	" Brokerage	23	40	0	0
						" 1	" Preliminary and Formation Expenses	19	4,750	0	0
						Mar. 7	" Debenture Issue Expenses	21	426	0	0
						" 7	" Balance carried down	√	43,609	0	0
			£79,675	0	0				£79,675	0	0
19... Mar. 7	To Balance brought down	√	43,609	0	0						

Chatenays, Ltd.

BALANCE SHEET, MARCH 7, 19....

			£	s.	d.		£	s.	d.
Capital :—						Sundry Assets	60,000	0	0
Nominal: 200,000 Ordinary Shares of £1 each	£200,000 0 0					Preliminary and Formation Expenses (including Brokerage)	4,790	0	0
Issued: 85,000 Ordinary Shares of £1 each	85,000 0 0					Underwriting Commission	2,100	0	0
Less Calls in Arrear	250 0 0		84,750	0	0	Debenture Issue Expenses Account	426	0	0
Ordinary Share Premiums Account			21,250	0	0	Debenture Discount Account	75	0	0
5% Debentures			5,000	0	0	Cash at Bank	43,609	0	0
			£111,000	0	0		£111,000	0	0

Note.—This Balance Sheet would not be laid before a General Meeting, and details of assets, etc., are therefore not compulsory.

EXAMINATION QUESTION.

A limited company was formed to purchase the business of Victor Hugo, whose Balance Sheet as at the date of purchase was as follows:—

BALANCE SHEET.

	£	s.	d.		£	s.	d.
Capital	15,000	0	0	Leasehold Factory . .	10,500	0	0
Sundry Creditors	4,200	0	0	Machinery and Plant . .	5,240	0	0
Loan from Bank	4,000	0	0	Sundry Debtors . . .	3,260	0	0
Bills Payable	600	0	0	Stock	3,100	0	0
				Cash at Bank . . .	420	0	0
				Bills Receivable . . .	1,280	0	0
	£23,800	0	0		£23,800	0	0

The purchase terms were as follows:—

(1) The purchase price was agreed at £17,500, payable as to £10,000 in cash and as to £7,500 in fully paid shares.

(2) Victor Hugo was to retain the Cash at Bank and Bills Receivable, and undertook to meet the Bills Payable.

(3) The company took over all the remaining assets at their book values and undertook to discharge the liabilities other than Bills Payable.

(4) The capital of the company, subscribed by the public, was £30,000 in Ordinary Shares of £1 each, of which 15*s*. was called up and fully paid.

(5) The Preliminary Expenses amounted to £586.

Give the entries necessary to open the books of the company upon the completion of the purchase, and submit the initial Balance Sheet. (*London Chamber Commerce.*)

Solution.

12

JOURNAL.

				Dr.			Cr.		
				£	s.	d.	£	s.	d.
19...									
Dec. 31	Purchase of Business Account	Dr.	1	17,500	0	0			
	To Vendors		5				17,500	0	0
	Being agreed purchase price of the business.								
,, 31	Sundry Assets	Dr.							
	Leasehold Factory		19	10,500	0	0			
	Machinery and Plant		21	5,240	0	0			
	Sundry Debtors		23	3,260	0	0			
	Stock		25	3,100	0	0			
	To Purchase of Business Account . . .		1				22,100	0	0
	Being book values of assets taken over.								
,, 31	Purchase of Business Account	Dr.	1	8,200	0	0			
	To Sundry Creditors		13				4,200	0	0
	,, Bank Loan		15				4,000	0	0
	Being liabilities taken over from Vendor.								
,, 31	Vendors	Dr.	5	7,500	0	0			
	To Share Capital Account		7				7,500	0	0
	Being 7,500 shares of £1 each issued as fully paid in part satisfaction of the purchase price.								
,, 31	Application, Allotment, and Call Account .	Dr.	9	22,500	0	0			
	To Share Capital Account		7				22,500	0	0
	Being transfer of the former account to Share Capital Account.								

CASH BOOK.

3 Dr. Cr. 3

			£	s.	d.				£	s.	d.
19... Dec. 31	To Sundry Shareholders (on Application, Allotment, and Call Account) . .	9	22,500	0	0	19... Dec. 31	By Vendors . .	5	1 ,000	0	0
						„ 31	„ Sundry Creditors.	13	4,200	0	0
						„ 31	„ Bank Loan .	15	4,000	0	0
						„ 31	„ Preliminary Expenses . .	17	586	0	0
						„ 31	„ Balance carried down . .	√	3,714	0	0
			£22,500	0	0				£22,500	0	0
19... Dec. 31	To Balance brought down . .	√	3,714	0	0						

LEDGER.

Purchase of Business Account.

1 Dr. Cr. 1

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Vendors . .	12	17,500	0	0	19... Dec. 31	By Sundry Assets .	12	22,100	0	0
„ 31	„ Sundry Creditors .		4,200	0	0	„ 31	„ Transfer to Goodwill Account .	27	3,600	0	0
„ 31	„ Bank Loan . .		4,000	0	0						
			£25,700	0	0				£25,700	0	0

Vendors.

5 Dr. Cr. 5

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Share Capital Account . .	12	7,500	0	0	19... Dec. 31	By Purchase of Business Account .	12	17,500	0	0
„ 31	„ Cash	C.B. 3	10,000	0	0						
			£17,500	0	0				£17,500	0	0

Share Capital Account.

7 Dr. Cr. 7

			£	s.	d.			J.	£	s.	d.
						19... Dec. 31	By Vendors. Fully paid shares .	12	7,500	0	0
						„ 31	„ Application, Allotment, and Call Account .	12	22,500	0	0
									£30,000	0	0

Application, Allotment, and Call Account.

9 Dr. Cr. 9

		J.	£	s.	d.			C.B.	£	s.	d.
19... Dec. 31	To Share Capital Account . .	12	22,500	0	0	19... Dec. 31	By Cash, Sundry Shareholders .	3	22,500	0	0

LEDGER—*continued.*

SUNDRY CREDITORS.

13 Dr. — Cr. 13

		C.B.	£	s.	d.			J.	£	s.	d.
19..						19..					
Dec. 31	To Cash	3	4,200	0	0	Dec. 31	By Purchase of Business Account	12	4,200	0	0

BANK LOAN.

15 Dr. — Cr. 15

		C.B.	£	s.	d.			J.	£	s.	d.
19...						19..					
Dec. 31	To Cash	3	4,000	0	0	Dec. 31	By Purchase of Business Account	12	4,000	0	0

PRELIMINARY EXPENSES ACCOUNT.

17 Dr. — Cr. 17

		C.B.	£	s.	d.				£	s.	d.
19..											
Dec. 31	To Cash	3	556	0	0						

LEASEHOLD FACTORY.

19 Dr. — Cr. 19

		J.	£	s.	d.				£	s.	d.
19..											
Dec. 31	To Purchase of Business Account	12	10,500	0	0						

MACHINERY AND PLANT.

21 Dr. — Cr. 21

		J.	£	s.	d.				£	s.	d.
19..											
Dec. 31	To Purchase of Business Account	12	5,240	0	0						

SUNDRY DEBTORS.

23 Dr. — Cr. 23

		J.	£	s.	d.				£	s.	d.
19..											
Dec. 31	To Purchase of Business Account	12	3,260	0	0						

STOCK.

25 Dr. — Cr. 25

		J.	£	s.	d.				£	s.	d.
19..											
Dec. 31	To Purchase of Business Account	12	3,100	0	0						

GOODWILL.

27 Dr. — Cr. 27

			£	s.	d.				£	s.	d.
19..											
Dec. 31	To Purchase of Business Account	1	3,600	0	0						

New Company.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
CAPITAL :—					Goodwill	3,600	0	0
Issued—					Leasehold Factory	10,500	0	0
7,500 shares of £1 each issued as fully paid to vendor	£7,500				Machinery and Plant	5,240	0	0
30,000 shares of £1 each issued to public, 15*s.* per share called up	22,500				Stock	3,100	0	0
		30,000	0	0	Sundry Debtors	3,260	0	0
					Cash at Bank	3,714	0	0
					Preliminary Expenses Account	586	0	0
		£30,000	0	0		£30,000	0	0

Note.—This Balance Sheet is not drawn up in a form complying with the requirements of the Eighth Schedule.

Reconstruction.—Reconstruction is not a term of any legal significance. It expresses re-organisation, and this may take many forms. Reconstruction of a company may become necessary by reason of financial losses, but frequently reconstruction is entered upon for quite different reasons. Thus a company may be re-organised for any one of the following purposes:—

(*a*) Amalgamation with one or more similar undertakings.

(*b*) Absorption of a smaller company.

(*c*) To enlarge the " objects " detailed in the Memorandum.

(*d*) In order to write off lost capital.

(*e*) To provide means to satisfy the claims of creditors, or the claims of Cumulative Preference Shareholders for arrears of dividend, otherwise than by payment in cash.

(*f*) Consolidation of existing share issues, or re-arrangement of the rights of various classes of shareholders *inter se*.

(*g*) Alteration of the denomination of the Shares, *e.g.* the issue of ten £1 shares for every share of £10 held.

(*h*) To alter the domicile of the company.

(*i*) To reduce or extinguish the uncalled liability on the issued shares.

In earlier days, under the Act of 1862, reconstruction involved liquidation and the formation of a new company. The Act of 1908 provided ample legal machinery for reconstruction in many of the above events without liquidation, and the Acts of 1929 and 1948 contain similar machinery.

We have already seen that, under S. 61, a company may, if authorised by its Articles, increase, consolidate, and subdivide its capital; convert its paid-up shares into stock; and cancel unissued shares.

We have also seen that, under S. 66, if authorised by the Articles, a company may, by special resolution subsequently confirmed by the Court, extinguish or reduce the liability on share capital not paid up; cancel share capital which is lost or unrepresented by assets; pay off paid-up share capital in excess of its wants.

Under S. 58 a company may utilise undivided profits to pay off Redeemable Preference Shares (see p. 304).

Further, by S. 206, a company may compromise with its creditors, or its shareholders, or any class of them. On application to the Court for power so to do, the Court may order a meeting of the creditors, or of the shareholders, to be summoned to consider the proposal, and if the compromise or arrangement is sanctioned by a majority in number representing three-fourths in value of the creditors, or class of creditors, or shareholders, or class of shareholders, present and voting either in person or by proxy, such compromise or arrangement may be sanctioned by the Court, and, if so, becomes binding upon the creditors or the shareholders concerned. This procedure is frequently made use of in reconstruction proceedings in cases where a proportion of the outside liabilities of the company are satisfied by the issue of shares, or the arrears of cumulative preference dividends are similarly satisfied, or the denomination and rights of the various classes of shares are to be re-arranged.

Very briefly stated, the steps necessary to carry out a scheme of reconstruction, otherwise than by procedure under S. 206, are as follows:—

(*a*) If reduction of capital is involved the Articles must give authority, or must be amended by special resolution to give authority, and the company must pass a special resolution reducing the capital.

(*b*) If the proposed reduction is for the purpose of cancelling shares not issued, any resolution specified by the Articles will suffice.

(*c*) If it is simply a repayment of Redeemable Preference Shares out of accumulated profits, the procedure is under S. 58.

(*d*) If the reduction is for any other purpose than in (*b*) or (*c*) above, the Court must be petitioned to sanction the scheme. If the Court approves, an order is made which must be filed with the Registrar and published as the Court may direct. The Court's order takes effect only after registration (S. 69).

One of the most common reasons for reconstruction is the need to provide further working capital. It is necessary, sometimes, in this connection, to form a new company, and to proceed under the powers conferred by S. 287. The new company takes over the assets of the old company, and allots shares with an uncalled liability in the new company, in consideration for the assets taken over, thus providing further working capital. By S. 55, Finance Act, 1927, transfer and share capital duties are remitted to the extent of the share capital of the transferor company, subject to certain conditions (see p. 473).

In practice, reconstruction schemes are sometimes very difficult and complicated. More particularly, for example, in cases where two or more issues of Debentures exist, secured upon different specific assets, followed by one or more issues of Preference Shares, with or without accumulated arrears of dividend, and with differing rights as to priority, and an issue of Ordinary Shares without preferential rights as to dividend or capital. The apportionment of the capital loss to be written off as between these different interests clearly needs nice adjustment. Having ascertained the capital loss to be provided for, and determined its incidence, it then becomes necessary in most cases to provide further working capital. Unless all these needs are satisfactorily provided for, the reconstruction scheme will come to naught.

In other cases, for instance (*c*), (*f*), (*g*), and (*h*) mentioned on p. 453, reconstructions impose very little work on the company book-keeper, for they entail no alteration in the books, except such amendments as may be necessary in the Share Register. The only new accounts involved will be a new Preliminary Expenses Account, and any new Share Capital Account to record the fresh issue of capital, if a fresh issue is made. To the former account all the expenses of reconstruction would be debited, the balance being written off over a reasonable period in the manner explained in connection with Debenture Issue and similar expenses.

The following three illustrations give the basic principles on which reconstruction book-keeping is based. They are purposely presented in simple form, in order that these principles should not be obscured by complicated detail.

Illustration 1.—Blanks, Ltd., decided to sell their undertaking to a new company registered as Blanks (19...), Ltd. The purchase price was fixed at £50,000, payable by the issue of 100,000 shares in the new company, credited with 10*s*. per share as paid. The new company was to pay the liabilities of the old company. Goodwill Account was to be written off; Machinery and Plant Account reduced to £20,000; and the balance of the Profit and Loss Account was to be written off. The Balance Sheet of the old company at the date of the proposed reduction was as follows:—

Blanks, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Issued Capital: 100,000 shares of £1 each, fully paid . .	100,000	0	0	Goodwill	20,000	0	0
Sundry Creditors . . .	40,200	0	0	Machinery and Plant . .	30,000	0	0
				Sundry Assets . . .	69,800	0	0
				Cash	400	0	0
				Profit and Loss Account .	20,000	0	0
	£140,200	0	0		£140,200	0	0

Assuming that the sale to the new company was duly effected, and that the balance of 10*s*. per share had been called and paid up, the following records would appear:—

REALISATION ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Sundry Assets, etc., transferred to the new company . .	140,200	0	0	19... Dec. 31	By Purchase Price from the new company .	50,000	0	0
					" 31	" Loss on Assets transferred to the new company . .	50,000	0	0
					" 31	" Sundry Creditors to be paid by the new company . .	40,200	0	0
		£140,200	0	0			£140,200	0	0

A Purchase of Business Account would be written up, as already explained on p. 440, to record the opening of the New Company.

The Balance Sheet of Blanks (19...), Ltd., would appear as follows:—

Blanks (19...), Ltd.

BALANCE SHEET, DECEMBER 31, 19...

Dr. Cr.

	£	s.	d.		£	s.	d.
Issued Capital: 100,000 shares of £1 each, 10s. per share credited, and 10s. per share called and paid up	100,000	0	0	Machinery and Plant	20,000	0	0
				Sundry Assets	69,800	0	0
				Cash	10,200	0	0
	£100,000	0	0		£100,000	0	0

Note.—This Balance Sheet is not prepared for laying before a General Meeting.

The above simple illustration serves to demonstrate the principles upon which the book-keeping entries are based. Further detail may now be introduced.

Illustration 2.—Uprichards, Ltd., after a series of trade losses, resolved by special resolution to wind-up, and to reconstruct by means of a sale to a new company to be called Uprichards (19...), Ltd. At the date of the confirmatory resolution the Balance Sheet of the old company was as follows:—

Uprichards, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Freehold Factory	78,500	0	0
200,000 Ordinary Shares of £1 each, fully paid		200,000	0	0	Machinery and Plant	47,800	0	0
Sundry Creditors	£6,000				Motor Lorries	3,880	0	0
Bank Loan	3,000				Stock	18,282	0	0
Bills Payable	2,000				Sundry Debtors	21,820	0	0
					Cash at Bank	718	0	0
		11,000	0	0	Profit and Loss Account (accumulated loss)	40,000	0	0
		£211,000	0	0		£211,000	0	0

The parties concerned consented to the following reconstruction scheme:—

(*a*) The new company was to take over the assets of the old company, but not the liabilities.

(*b*) The capital of the new company was to consist of 500,000 Ordinary Shares of £1 each.

(*c*) The new company was to purchase the assets of the old company for £160,000, payable as to £140,000 by the issue of 280,000 Ordinary Shares of £1 each, credited with 10*s*. per share as paid up, and £20,000 in cash.

(*d*) The balance of 10*s*. per share payable by the members of the new company was to be paid as to 5*s*. on application and 5*s*. on allotment.

All moneys due on the new shares were paid. The expenses of reconstruction amounted to £9,000, and the preliminary and registration expenses of the new company to £5,000.

The following entries are necessary to record the reconstruction:—

JOURNAL.

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
19... Dec. 31	Realisation Account . . . . . Dr.	23	171,000	0	0			
	To Sundries :—							
	Freehold Factory	9				78,500	0	0
	Machinery and Plant	11				47,800	0	0
	Motor Lorries	13				3,880	0	0
	Stock	15				18,282	0	0
	Sundry Debtors	17				21,820	0	0
	Cash at Bank					718	0	0
	Being the transfer of these assets to the new company as per terms of the scheme dated this day.							
" 31	Uprichards (19...), Ltd. . . . . Dr.	25	160,000	0	0			
	To Realisation Account	23				160,000	0	0
	Being agreed purchase price of the assets of the old company.							
" 31	Shares in Uprichards (19...), Ltd. (the new company) . . . . Dr.	27	140,000	0	0			
	To Uprichards (19...), Ltd.	25				140,000	0	0
	Being the issue of 280,000 shares (10s. paid) as part purchase price of the assets as per scheme dated this day.							
" 31	Realisation Account . . . . . Dr.	23	9,000	0	0			
	To Sundry Creditors	3				9,000	0	0
	Being cost of reconstruction scheme.							
" 31	Cash . . . . Dr.	19	20,000	0	0			
	To Uprichards (19...), Ltd.	25				20,000	0	0
	Being the cash portion of the purchase price as per scheme dated this day.							
" 31	Sundries :— Dr.							
	Sundry Creditors	3	15,000	0	0			
	Bank Loan	5	3,000	0	0			
	Bills Payable	7	2,000	0	0			
	To Cash	19				20,000	0	0
	For cash paid in discharge of the old company's liabilities, and costs of reconstruction scheme. (*Note.*—In practice this entry would be omitted.)							
" 31	Share Capital Account (old company). . Dr.	1	60,000	0	0			
	To Sundries :—							
	Profit and Loss Account	21				40,000	0	0
	Realisation Account	23				20,000	0	0
	Being balance at the debit of the old company's Profit and Loss Account, and loss on the transfer of the business to the new company in accordance with the scheme dated this day.							

On distribution of the shares to the shareholders of Uprichards, Ltd., the following Journal entry would close the books of the old company:—

		Dr.			Cr.		
		£	s.	d.	£	s.	d.
Share Capital Account . . . . Dr.		140,000	0	0			
To Shares in Uprichards (19...), Ltd. . .					140,000	0	0

1

SHARE CAPITAL ACCOUNT.

DR. CR.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Profit and Loss Account (debit balance transferred) . .	26	40,000	0	0	19... Dec. 31	By Balance . .	√	200,000	0	
„ 31	„ Realisation Account (loss on realisation) .	26	20,000	0	0						
„ 31	„ Balance carried down . .	√	140,000	0	0						
			£200,000	0	0				£200,000	0	
						19... Dec. 31	By Balance brought down . .	√	140,000	0	

3

SUNDRY CREDITORS.

DR. CR.

		J.	£	s.	d.				£	s.	
19... Dec. 31	To Cash . . .	26	15,000	0	0	19... Dec. 31	By Balance . .	√	6,000	0	
						„ 31	„ Costs of Realisation . .	26	9,000	0	
			£15,000	0	0				£15,000	0	

5

BANK LOAN.

DR. CR.

		J.	£	s.	d.				£	s.
19... Dec. 31	To Cash . . .	26	3,000	0	0	19... Dec. 31	By Balance . .	√	3,000	0
			£3,000	0	0				£3,000	0

7

BILLS PAYABLE.

DR. CR.

		J.	£	s.	d.				£	s.
19... Dec. 31	To Cash . .	26	2,000	0	0	19... Dec. 31	By Balance . .	√	2,000	0
			£2,000	0	0				£2,000	0

9

FREEHOLD FACTORY.

DR. CR.

			£	s.	d.			J.	£	s.
19... Dec. 31	To Balance . .	√	78,500	0	0	19... Dec. 31	By Realisation Account . .	26	78,500	0
			£78,500	0	0				£78,500	0

LEDGER—*continued.*

11 **MACHINERY AND PLANT.** 11

Dr. Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance	√	47,800	0	0	Dce. 31	By Realisation Account	26	47,800	0	0
			£47,800	0	0				£47,800	0	0

13 **MOTOR LORRIES.** 13

Dr. Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance	√	3,880	0	0	Dec. 13	By Realisation Account	26	3,880	0	0
			£3,880	0	0				£3,880	0	0

15 **STOCK.** 15

Dr. Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance	√	18,282	0	0	Dec. 31	By Realisation Account	26	18,282	0	0
			£18,282	0	0				£18,282	0	0

17 **SUNDRY DEBTORS.** 17

Dr. Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance	√	21,820	0	0	Dec. 31	By Realisation Account	26	21,820	0	0
			£21,820	0	0				£21,820	0	0

19 **CASH AT BANK.** 19

Dr. Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance	√	718	0	0	Dec. 31	By Realisation Account	26	718	0	0
„ 31	„ Cash, Uprichards (19), Ltd., balance of purchase price	J. 26	20,000	0	0	„ 31	„ Sundry Creditors	26	20,000	0	0
			£20,718	0	0				£20,718	0	0

21 **PROFIT AND LOSS ACCOUNT.** 21

Dr. Cr.

19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance	√	40,000	0	0	Dec. 31	By Share Capital Account	26	40,000	0	0
			£40,000	0	0				£40,000	0	0

LEDGER—*continued.*

23 REALISATION ACCOUNT. 23

Dr. Cr.

		J.	£	s.	d.			J.	£	s.	d.
19...						19...					
Dec. 31	To Sundry Assets	26	171,000	0	0	Dec. 31	By Uprichards (19...), Ltd. (purchase price)	26	160,000	0	0
„ 31	„ Sundry Creditors (expenses of realisation)	26	9,000	0	0	„ 31	„ Share Capital Account	26	20,000	0	0
			£180,000	0	0				£180,000	0	0

25 UPRICHARDS (19...), LTD. 25

Dr. Cr.

		J.	£	s.	d.			J.	£	s.	d.
19...						19...					
Dec. 31	To Agreed Purchase Price of old Company	26	160,000	0	0	Dec. 31	By Shares issued to old company as part purchase price	26	140,000	0	0
						„ 31	„ Cash	26	20,000	0	0
			£160,000	0	0				£160,000	0	0

27 SHARES IN NEW COMPANY. 27

Dr. Cr.

		J.	£	s.	d.				£	s.	d.
19...											
Dec. 31	To 280,000 Shares (10s. paid) in Uprichards (19...), Ltd.	26	140,000	0	0						

The initial Balance Sheet of the new company, Uprichards (19...), Ltd., would appear as follows:—

Uprichards (19...), Ltd.

BALANCE SHEET, JANUARY 1, 19...

	£	s.	d.		£	s.	d.
CAPITAL :— *Nominal :* 500,000 Ordinary Shares of £1 each . . . £500,000				Sundry Assets taken over from the old company and written down to new valuations (set out details)	160,000	0	0
				Preliminary Expenses	5,000	0	0
Issued : 280,000 Ordinary Shares of £1 each (issued with 10s. paid), fully paid	280,000	0	0	Cash at Bank	115,000	0	0
	£280,000	0	0		£280,000	0	0

A reconstruction embracing rather different characteristics, and treated, in some respects, on somewhat different lines, may now be given.

Illustration 3.—Blanks, Ltd., was registered with a capital of £100,000, divided into 30,000 6% Cumulative Preference Shares of £1 each and 70,000 Ordinary Shares of £1 each. Both classes of shares were fully subscribed and paid up. The company had also issued 120 5% Debentures of £100 each.

On December 31, 19..., the Balance Sheet of the company was as follows:—

Blanks, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Issued Capital:—					Goodwill	20,000	0	0
30,000 6% Preference Shares of £1 each .	£30,000				Leasehold Property . . .	34,762	0	0
70,000 Ordinary Shares of £1 each . .	70,000				Patents	10,600	0	0
		100,000	0	0	Machinery and Plant . . .	24,564	0	0
5% Debentures		12,000	0	0	Stock	14,753	0	0
,, ,, Interest Accrued .		600	0	0	Sundry Debtors . . .	6,557	0	0
Sundry Creditors . . .		12,000	0	0	Cash at Bank	234	0	0
					Profit and Loss Account (Balance)	12,500	0	0
		£124,600	0	0		£124,600	0	0

Note.—Two years' Dividend on the Preference Shares is in arrear.

The company's creditors were pressing, the Debenture interest was twelve months in arrear, the dividend for the two years on the Preference Shares was in arrear, and working capital was urgently needed.

Meetings of the debenture holders, the two classes of shareholders, and the creditors were held, and the following scheme was agreed to by all parties and sanctioned by the Court:—

(*a*) A new company was to be registered as Blanks (19...), Ltd., with a capital of 250,000 Ordinary Shares of 5*s*. each.

The purchase price of the old company's business was to be satisfied by the issue of a sufficient number of fully paid shares of the new company to meet the various agreements set out in the following paragraphs:—

(*b*) Two Ordinary Shares of 5*s*. each were to be issued as fully paid to the holder of each Preference Share of £1 in the old company.

(*c*) The arrears of preference dividend were to be satisfied by the issue of two fully paid shares of 5*s*. each in the new company for every £1 due.

(*d*) The debenture holders were to accept fully paid shares of 5*s*. each in the new company in satisfaction of the accrued interest.

(*e*) The creditors were to receive 15*s*. in the £ on their debts, to be satisfied by a cash payment of 10*s*. in the £ and the balance of 5*s*. by the issue of fully paid shares in the new company.

(*f*) One fully paid share of 5*s*. in the new company was to be issued for every Ordinary Share of £1 in the old company.

The balance of the capital of the new company was fully subscribed and paid up by several of the largest shareholders in the old company.

The amount rendered available by the reconstruction scheme was to be utilised as follows:—

The patents, goodwill, and the debit balance of the Profit and Loss Account were to be written off; Machinery and Plant was to be reduced by £10,000; Stock by £9,000; and Leasehold Property by the balance available.

You are required to prepare:—

(1) A Statement showing the shares to be allotted as fully paid by the new company.

(2) The Journal entries recording the fulfilment of the reconstruction scheme.

(3) The Cash Book.

(4) The following Ledger accounts: Realisation Account and New Share Capital Account. (No other Ledger accounts are required.)

(5) The initial Balance Sheet of the reconstructed company.

It is assumed that Debentures in the new company were issued in exchange for Debentures in the old company, and that the Sundry Debtors and Balance of Cash were taken over by the new company, and that the creditors were paid off by the old company.

OLD COMPANY'S BOOKS.

JOURNAL.

	Dr.			Cr.		
	£	s.	d.	£	s.	d.
Realisation Account . . . . . Dr.	81,200	0	0			
To Sundry Assets, viz. :—						
Leasehold Property				34,762	0	0
Machinery and Plant				24,864	0	0
Sundry Debtors				6,587	0	0
Stock				14,753	0	0
Cash				234	0	0
Being sundry assets taken over by Blanks (19...), Ltd., under reconstruction scheme.						
5% Debentures Account . . . . . Dr.	12,000	0	0			
To Realisation Account				12,000	0	0
Being Debentures taken over by Blanks (19...), Ltd., under reconstruction scheme.						
Blanks (19...), Ltd. . . . . . . Dr.	43,900	0	0			
To Realisation Account				43,900	0	0
Being agreed consideration under reconstruction scheme.						
Sundry Creditors . . . . . . Dr.	3,000	0	0			
To Reconstruction Account				3,000	0	0
Being amount written off Sundry Creditors under reconstruction scheme.						
Preference Share Capital Account . . Dr.	15,000	0	0			
Ordinary Share Capital Account . . Dr.	52,500	0	0			
To Reconstruction Account				67,500	0	0
Being amounts surrendered under reconstruction scheme.						
Reconstruction Account . . . . . Dr.	1,800	0	0			
To Preference Shareholders' Account . .				1,800	0	0
Being arrears of Preference Dividend, at 10s. in the £, under reconstruction scheme.						
Reconstruction Account . . . . . Dr.	25,300	0	0			
To Realisation Account				25,300	0	0
Being difference between consideration and net assets taken over under reconstruction scheme.						
Reconstruction Account . . . . . Dr.	43,400	0	0			
To Goodwill				20,000	0	0
„ Patents				10,600	0	0
„ Profit and Loss Account				12,800	0	0
Being sundry debit balances written off under reconstruction scheme.						
Cash . . . . Dr.	6,000	0	0			
Ordinary Shares in Blanks (19...), Ltd. . Dr.	37,900	0	0			
To Blanks (19...), Ltd.				43,900	0	0
Being satisfaction of consideration.						
Sundries :— Dr.						
Preference Share Capital Account . .	15,000	0	0			
Preference Shareholders' Account . .	1,800	0	0			
Ordinary Share Capital Account . . .	17,500	0	0			
Debenture Interest Account . . .	600	0	0			
Sundry Creditors	9,000	0	0			
To Ordinary Shares in Blanks (19...), Ltd. .				37,900	0	0
„ Cash				6,000	0	0
Being distribution of consideration in accordance with the scheme.						

NEW COMPANY'S BOOKS.

JOURNAL.

	Dr. £	s.	d.	Cr. £	s.	d.
Sundries :— Dr.						
To Sundries :						
Leasehold Property	28,462	0	0			
Machinery and Plant	14,864	0	0			
Stock	5,753	0	0			
Sundry Debtors	6,587	0	0			
Cash	234	0	0			
5% Debentures				12,000	0	0
Blanks, Ltd.				43,900	0	0
Being sundry assets and debentures taken over, and consideration therefor.						
Blanks, Ltd. . . . . Dr.	37,900	0	0			
To Ordinary Share Capital Account . .				37,900	0	0
Being 151,600 Ordinary Shares of 5*s.* each allotted as fully paid as per resolution of Directors, dated .... in part consideration.						
Cash . . . . Dr.	24,600	0	0			
To Ordinary Share Capital Account . .				24,600	0	0
Being cash payment in full for 98,400 Ordinary Shares of 5*s.* each, allotted as per resolution of Directors dated						
Blanks, Ltd. . . . . Dr.	6,000	0	0			
To Cash				6,000	0	0
Being balance of consideration.						

OLD COMPANY'S BOOKS.

CASH BOOK.

Dr.	£	s.	d.	Cr.	£	s.	d.
To balance . .	234	0	0	By Realisation Account	234	0	0
" Blanks (19...), Ltd. .	6,000	0	0	" Sundry Creditors .	6,000	0	0
	£6,234	0	0		£6,234	0	0

REALISATION ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Sundry Assets, transferred . .	81,200	0	0	By 5% Debentures .	12,000	0	0
				" Blanks (19...), Ltd., consideration .	43,900	0	0
				" Reconstruction Account . .	25,300	0	0
	£81,200	0	0		£81,200	0	0

RECONSTRUCTION ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Preference Shareholders' Account *re* dividend . .	1,800	0	0	By Share Capital Accounts, amounts written off . .	67,500	0	0
" Realisation Account	25,300	0	0	" Sundry Creditors .	3,000	0	0
" Sundry Assets, etc., written off . .	43,400	0	0				
	£70,500	0	0		£70,500	0	0

NEW COMPANY'S BOOKS.

CASH BOOK.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Blanks, Ltd. .	234	0	0	By Blanks, Ltd. . .	6,000	0	0
„ Ordinary Shares Capital Account .	24,600	0	0	„ Balance carried down . . .	18,834	0	0
	£24,834	0	0		£24,834	0	0
To Balance brought down . . .	18,834	0	0				

Blanks (19...), Ltd.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Capital:—				Leasehold Property . . .	28,462	0	0
Nominal and Issued: 250,000 Ordinary Shares of 5s. each, fully paid	62,500	0	0	Machinery and Plant . .	14,864	0	0
5% Debentures . . .	12,000	0	0	Stock	5,753	0	0
				Sundry Debtors . . .	6,587	0	0
				Cash	18,834	0	0
	£74,500	0	0		£74,500	0	0

Note.—This Balance Sheet is not intended to be laid before a General Meeting.

Amalgamation.—Combines for the purpose of amalgamating the assets, liabilities, and interests of two or more businesses engaged in the same trade are a growing feature of modern commerce. The procedure of amalgamation usually involves: (*a*) the liquidation of all the combining companies, and the formation of a new company to purchase the combined undertakings, or (*b*) an increase of the capital of one member of the combine, and the issue of new shares to the other members, in satisfaction of the agreed purchase price of their businesses.

Holding (Parent) Companies.—Sometimes these combines take the form of Holding or Parent Companies formed to acquire the whole, or a controlling majority of the shares in other companies, called *Subsidiary Companies*. Frequently also the parent company conducts a trading business on its own account. The object of such companies is to control the operations of the subsidiaries, and to effect economy and harmony in their working. It is a simple and economical method of effecting a working amalgamation of companies engaged in similar trades.

A holding company, and its subsidiaries are known collectively as a "group." For many years past the larger business undertakings in this country, and still more in the United States, have tended to become organised in groups. The principal reason for this is that there is a limit to the size of a business which can be efficiently managed as a single undertaking, and when this limit is passed better control is obtained by organising it as a collection of units, each of moderate size, and all subject to the overall general control of the parent or holding company. The control is exercised, normally, by the appointment to the boards of the subsidiary companies of persons who are either themselves directors of the holding company or who are the nominees of, and under the control of, those directors.

Prior to 1948 the only special statutory requirement as regards the accounts of a holding company was that (by S. 126 of the Companies Act, 1929) a holding company had to annex to its Balance Sheet a statement, signed by the persons required to sign the Balance Sheet (of the holding company), showing how the profits and losses of the subsidiary companies had been dealt with for the purposes of the accounts of the holding company. Also, if the auditors of any subsidiary company had qualified their report, such qualification had to be stated. It was becoming more and more common for a "Consolidated Balance Sheet," showing the position of the undertaking as a single body, and less commonly a "Consolidated Profit and Loss Account" to be set before the members of the holding company, but there was no statutory necessity to do so. Such statements were usually the subject of some sort of report by the auditors of the holding company, but such report, again, was non-statutory.

Under the 1948 Act every holding company (with stated exceptions) is under an obligation to lay group accounts before its members (S. 150) at the same time as its own accounts. These accounts are normally to consist of a Consolidated Balance Sheet and a Consolidated Profit and Loss Account (S. 151), but some latitude is allowed if the directors consider that some other method is preferable (S. 151 [2]), and the group accounts may be wholly or partly incorporated in the holding company's own accounts (S. 151 [3]). Consolidated accounts, if prepared, must comply with the provisions of the Eighth Schedule, Part II. The preparation of consolidated accounts is a subject of great and still growing importance, and (except in simple cases) often involves accounting problems of great difficulty. The subject is too large to be dealt with in full detail in this treatise, but the legal requirements, together with some simple illustrations, will be found set out in Chapter XIII. For a somewhat fuller description the reader is referred to the Author's *Accounting*.

We will now return to amalgamations proper.

Illustration.—Inchiquins, Ltd., and Uprichards, Ltd., agreed to amalgamate. A new company, Soleil d'Or, Ltd., was registered to take over the combined undertaking as on January 1, 19.... After negotiation, the assets and liabilities of the two companies were revalued, and agreed as set out in the following revised Balance Sheets.

Inchiquins, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Issued Capital :—				Freehold Factory	96,542	0	0
150,000 Ordinary Shares of £1 each, fully paid	150,000	0	0	Machinery and Plant	24,485	0	0
Sundry Creditors	17,815	0	0	Motor Lorries	4,271	0	0
Reserve Account	10,000	0	0	Stock	21,325	0	0
Profit and Loss Account (undistributed balance)	5,000	0	0	Sundry Debtors	21,842	0	0
				Cash at Bank	14,350	0	0
	£182,815	0	0		£182,815	0	0

Uprichards, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
Issued Capital:—				Freehold Warehouse . .	32,741	0	0
50,000 Ordinary Shares of £1 each, fully paid . . .	50,000	0	0	Machinery and Plant . .	12,930	0	0
Sundry Creditors . . .	8,000	0	0	Patents	2,000	0	0
Profit and Loss Account (undistributed balance) . . .	10,000	0	0	Stock	9,000	0	0
				Sundry Debtors . . .	10,889	0	0
				Cash at Bank . . .	440	0	0
	£68,000	0	0		£68,000	0	0

The capital of the new company on the basis of the above revised Balance Sheets will be as follows:—

	Total Assets.	Liabilities.	Net Assets.
	£	£	£
Inchiquins, Ltd. . . .	182,815	17,815	165,000
Uprichards, Ltd. . .	68,000	8,000	60,000
Capital of the new company =			£225,000

The capital of the new company, issued as fully paid, will be divided as shown above. This means that the shareholders of Inchiquins, Ltd., will receive eleven new shares for every ten old shares held, and the shareholders of Uprichards, Ltd., will receive six new shares for every five old shares held. In actual practice, fractions generally arise that cannot be accurately allotted. These shares are therefore sold by the Liquidator, and the proceeds divided proportionately amongst the shareholders entitled to the fractions incapable of allotment. An alternative method is to issue *fractional certificates*. For example, if a shareholder is entitled to one-quarter of a £1 share, a fractional certificate is issued to him with 5*s*. credited as paid up. This can either be paid up in full by the recipient or sold.

Sometimes arrangements are made with one or more of the shareholders who agree to purchase all fractions. The individual shareholders are then given provisional "fractional certificates" (carrying no dividend or voting rights) which, if presented within a given time, with other fractions to complete a whole share, will be exchanged for a share certificate. This practice obviates the issue of "partly paid" share certificates.

The initial Balance Sheet of the new company, Soleil d'Or, Ltd., will appear as follows:—

Soleil d'Or, Ltd.

BALANCE SHEET, JANUARY 1, 19...

	£	s.	d.		£	s.	d.
Capital:—				Freehold Factory and Warehouse	129,583	0	0
Issued: 225,000 Ordinary Shares of £1 each, fully paid	225,000	0	0	Machinery and Plant . .	37,415	0	0
Sundry Creditors . . .	25,815	0	0	Patents	2,000	0	0
				Motor Lorries. . . .	4,271	0	0
				Stock	30,325	0	0
				Sundry Debtors . . .	32,731	0	0
				Cash at Bank . . .	14,490	0	0
	£250,815	0	0		£250,815	0	0

Note.—The fixed assets are stated at cost price to the new company.

Absorption.—The absorption of one company by another is to all intents identical with the amalgamation of two companies, except that, in the latter case, a new company is usually formed to purchase the assets of the amalgamating companies. When an absorption takes place, the larger company—the absorbing company—actually has or creates sufficient unissued capital to issue shares in satisfaction of the agreed purchase price of the undertaking absorbed. The policy of absorption has been extensively practised in the banking world, the objects being to extend operations, to eliminate competition, and to secure economy in working expenses. Absorption involves either a profit or a loss to the company absorbed, according to whether the price paid by the purchasing company for the assets of the vendor company is greater or less than the values at which those assets stand in the books of the vendor.

Illustration.—Chatenays, Ltd., agreed to absorb the business of Dicksons, Ltd., as on December 31, 19.... Chatenays agreed to discharge Dicksons' liabilities, to pay the expenses of absorption (£2,000), and to take over the assets at their Balance Sheet values. The purchase price was to be satisfied by the issue of twelve £1 shares in Chatenays, Ltd., for every share of £10 in Dicksons, Ltd. The Balance Sheets of the two companies were as follows:—

Chatenays, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital:—					Freehold Warehouse	78,000	0	0
Nominal: 400,000 Ordinary Shares of £1 each	£400,000				Machinery and Plant	57,862	0	0
					Goodwill	30,000	0	0
					Stock	21,420	0	0
Issued: 200,000 Shares of £1 each	Ordinary	200,000	0	0	Sundry Debtors	39,238	0	0
Reserve Account		30,000	0	0	Cash at Bank	12,480	0	0
Sundry Creditors		14,000	0	0	Profit and Loss Account (Balance)	5,000	0	0
		£244,000	0	0		£244,000	0	0

Dicksons, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

	£	s.	d.		£	s.	d.
apital:—				Freehold Factory	45,500	0	0
10,000 Ordinary Shares of £10 each	100,000	0	0	Machinery and Plant	29,864	0	0
undry Creditors	12,462	0	0	Stock	19,434	0	0
ills Payable	9,538	0	0	Sundry Debtors	18,462	0	0
				Cash at Bank	8,740	0	0
	£122,000	0	0		£122,000	0	0

The necessary entries in the books of Chatenays, Ltd., are as follows:—

LEDGER.

1 SUNDRY ASSETS. 1

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance of Sundry Asset Accounts of old company as per Balance Sheet (other than cash and good will, but including Profit and Loss Account) .	✓	201,520	0	0						
" 31	" Sundry Assets, Dicksons, Ltd. (other than cash)	J. 2	113,260	0	0						
			£314,780	0	0						

3 SHARE CAPITAL ACCOUNT. 3

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Balance . .	✓	200,000	0	0
						" 31	" 120,000 Shares, issued as fully paid as purchase price of Dicksons, Ltd.	J. 2	120,000	0	0
									£320,000	0	0

5 RESERVE ACCOUNT. 5

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Balance . .	✓	30,000	0	0

7 GOODWILL ACCOUNT. 7

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance (Chatenays) . .	✓	30,000	0	0						
" 31	" Dicksons, Ltd. .	J. 2	20,000	0	0						
			£50,000	0	0						

9 SUNDRY CREDITORS. 9

Dr. Cr.

			£	s.	d.				£	s.	d.
						19... Dec. 31	By Balance (Chatenays) . .	✓	14,000	0	0
						" 31	" Sundries (Dicksons) . .	J. 2	22,000	0	0
									£36,000	0	0

LEDGER—*continued.*

11 Dicksons, Limited. 11

Dr.											Cr.
19...		J.	£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Fully Paid Shares	2	120,000	0	0	Dec. 31	By Sundry Assets .	2	122,000	0	0
„ 31	„ Sundry Liabilities . .	2	22,000	0	0	„ 31	„ Goodwill Account . .		20,000	0	0
			£142,000	0	0				£142,000	0	0

13 Absorption Expenses Account. 13

Dr.											Cr.
19...		J.	£	s.	d.				£	s.	d.
Dec. 31	To Cash . .	2	2,000	0	0						

15 CASH BOOK. 15

Dr.											Cr.
19...			£	s.	d.	19...		J.	£	s.	d.
Dec. 31	To Balance . .	√	12,480	0	0	Dec. 31	By Absorption Expenses . .	2	2,000	0	0
„ 31	„ Cash (Dicksons, Ltd.) . .		8,740	0	0	„ 31	„ Balance carried down . .	√	19,220	0	0
			£21,220	0	0				£21,220	0	0
19... Dec. 31	To Balance brought down . .	√	19,220	0	0						

Chatenays, Ltd.

2 JOURNAL.

			Dr.			Cr.		
19...			£	s.	d.	£	s.	d.
Dec. 31	Sundries :— Dr.							
	Freehold Factory	1	45,500	0	0			
	Machinery and Plant	1	29,864	0	0			
	Sundry Debtors	1	18,462	0	0			
	Stock	1	19,434	0	0			
	Cash at Bank	15	8,740	0	0			
	To Dicksons, Ltd.	11				122,000	0	0
	For the assets taken over as per agreement, dated December 18, 19...							
„ 31	Dicksons, Ltd. . . . . . Dr.	11	120,000	0	0			
	To Share Capital Account	3				120,000	0	0
	Being 120,000 shares of £1 each issued as fully paid to the shareholders of Dicksons, Ltd., as purchase price of the company's undertaking as per agreement, dated December 18, 19...							
„ 31	Absorption Expenses Account . . . Dr.	13	2,000	0	0			
	To Cash	15				2,000	0	0
	Being costs of absorption to be written off over three years.							
„ 31	Dicksons, Ltd. . . . . . Dr.	11	22,000	0	0			
	To Sundry Creditors	9				12,462	0	0
	„ Bills Payable	9				9,538	0	0
	For discharge of these liabilities taken over as per agreement, dated December 18, 19...							
„ 31	Goodwill Account . . . . . . Dr.	7	20,000	0	0			
	To Dicksons, Ltd.	11				20,000	0	0
	Being amount represented by goodwill included in the purchase.							

atenays, Ltd.

BALANCE SHEET, DECEMBER 31, 19....

(AFTER ABSORPTION.)

				£	s.	d.		£	s.	d.	£	s.	d.
apital :							Freehold Property :—						
Nominal : 400,000 Ordinary Shares of £1 each	£400,000	0	0				Chatenays, Ltd.	78,000	0	0			
							Dicksons, Ltd.	45,500	0	0	123,500	0	0
							Machinery and Plant :—						
Issued : 320,000 Ordinary Shares of £1 each				320,000	0	0	Chatenays, Ltd.	57,862	0	0			
eserve Account				30,000	0	0	Dicksons, Ltd.	29,864	0	0	87,726	0	0
undry Creditors—							Goodwill :—						
Chatenays, Ltd.	14,000	0	0				Chatenays, Ltd.	30,000	0	0			
Dicksons, Ltd.	12,462	0	0	26,462	0	0	Dicksons, Ltd.	20,000	0	0	50,000	0	0
ills Payable				9,538	0	0	Stock :—						
							Chatenays, Ltd.	21,420	0	0			
							Dicksons, Ltd.	19,434	0	0	40,854	0	0
							Sundry Debtors :—						
							Chatenays, Ltd.	39,238	0	0			
							Dicksons, Ltd.	18,462	0	0	57,700	0	0
							Cash at Bank				19,220	0	0
							Profit and Loss Account (Chatenays, Ltd.)				5,000	0	0
							Absorption Expenses Account				2,000	0	0
				£386,000	0	0					£386,000	0	0

Note.—If the Balance Sheet is laid before a General Meeting, details of the bases of valuation of fixed assets, etc., must be given.

Dicksons, Ltd.

2 JOURNAL.

				Dr.			Cr.		
19...				£	s.	d.	£	s.	d.
Dec. 31	Realisation Account	Dr.	L.F.	122,000	0	0			
	To Sundries :—								
	Freehold Factory		—				45,500	0	0
	Machinery and Plant		—				29,864	0	0
	Sundry Debtors		—				18,462	0	0
	Stock		—				19,434	0	0
	Cash at Bank		—				8,740	0	0
	Being the assets taken over by Chatenays, Ltd., as per agreement dated December 18, 19...								
„ 31	Sundries :—	Dr.							
	Sundry Creditors		L.F.	12,462	0	0			
	Bills Payable		—	9,538	0	0			
	To Realisation Account		—				22,000	0	0
	Being liabilities taken over by Chatenays, Ltd., as per agreement dated December 18, 19...								
„ 31	Chatenays, Ltd., Fully Paid Shares Account.	Dr.	L.F.	120,000	0	0			
	To Realisation Account		—				120,000	0	0
	Being 120,000 fully paid Ordinary Shares issued by Chatenays, Ltd., in settlement of purchase price as per agreement dated December 18, 19...								

Reconstruction, Amalgamation, Absorption.—These terms, often employed somewhat loosely, appear to confuse some students. It may be useful, therefore, briefly to recapitulate the chief signification of the terms. It may be pointed out in this place, that a limited company has no implied power to promote or acquire other companies, or to dispose of its undertaking unless such power exists under the Memorandum, although, upon liquidation, the liquidator has such power.

Reconstruction.—This term usually, but far from invariably, indicates that trading losses and financial stringency have compelled the company to re-value, or write off, some of its assets, and to reduce its capital to a like extent.

Amalgamation.—This term usually means that all the companies entering into the combination have been liquidated, and that the amalgamated assets have been purchased by a new company formed for the purpose.

Absorption.—This term indicates that a stronger has purchased or absorbed a weaker company, shares in the stronger or absorbing company being allotted to the shareholders of the company absorbed in satisfaction of the purchase price of the absorbed company's assets.

None of the above terms have any precise legal significance, notwithstanding that they are in common use.

Dissentient Shareholders.—In a reconstruction or amalgamation it frequently happens that the assets of the old company are sold for shares in the new. But a shareholder may be unwilling to accept such shares, especially if, being only partly paid, they involve liability for calls. He is protected by S. 287 (where the scheme is under that section) of the Act of 1948. Provided that he has not voted in favour of the resolution giving the liquidator power to sell the assets for shares, he may by notice in writing, addressed to the liquidator and left at the registered office of the company, within seven days after the passing of the resolution, require the liquidator either to refrain from carrying the resolution into effect or to purchase his interest at a price to be fixed by agreement or arbitration. The Articles cannot deprive him of this right. If the liquidator elects to purchase the dissentient shareholder's interest he must pay the price before the company is dissolved.

If the resolution to sell for shares is not sanctioned by the Court, and an order for winding-up the company is made within a year, the special resolution authorising the scheme will not be valid. Where there is any possibility of this occurring, the liquidator should apply for a supervision order.

If the Memorandum contains the necessary power (as it usually does), a company may sell its undertaking for shares before it goes into liquidation; but it cannot divide the proceeds until wound-up. Distribution of capital can be made only in a winding-up, or by Order of the Court under S. 208.

Where an application has been made to the Court under S. 206 (see p. 454) for the sanctioning of a compromise or arrangement between a company and its members and or creditors, and it is shown that the compromise or arrangement has been proposed for the purposes of or in connection with a scheme for the reconstruction of any company or companies or the amalgamation of any two or more companies, and that under the scheme the whole or any part of the undertaking or the property of any company concerned in the scheme (*i.e.* a transferor company) is to be transferred to another company (*i.e.* a transferee company) the Court may make provision for all or any of the following matters:—

(*a*) the transfer to the transferee company of the whole or any part of the undertaking and of the property or liabilities of any transferor company;

(*b*) the allotting or appropriation by the transferee company of any shares, debentures, policies, or other like interests in that company which under the compromise or arrangement are to be allotted or appropriated by that company to or for any person;

(*c*) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;

(*d*) the dissolution, without winding up, of any transferor company;

(*e*) the provision to be made for dissentients;

(*f*) such other matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out (S. 208 [1]).

The order of the Court itself effects the transfer of any property or liabilities specified, without further formality (S. 208 [2]). A copy of the order must be registered with the Registrar of Companies within seven days after the making of the order (S. 208 [3]).

Where a scheme or contract involving the transfer of shares or any class of shares in a transferor company to a transferee company has within four months after the making of the offer in that behalf by the transferee company been approved by the holders of not less than nine-tenths in value of the shares affected, the transferee company may, at any time within two months after the expiration of the said four months, give notice in the prescribed manner (statutory forms are prescribed) to any dissenting shareholder that it desires to acquire his shares, and where such a notice is given, the transferee company shall, unless on an application made by the dissenting shareholder within one month from the date on which the notice was given the Court thinks fit to order otherwise, be entitled and bound to acquire those shares on the terms on which under the scheme or contract the shares of the approving shareholders are to be transferred to the transferee company (S. 209 [1]).

Where a notice has been given by the transferee company under the above provision, and the Court has not ordered to the contrary, the transferee company shall, on the expiration of one month from the date on which the notice has been given, or, if an application to the Court by the dissenting shareholder is then pending, after that application has been disposed of, transmit a copy of the notice to the transferor company and pay or transfer to the transferor company the amount or other consideration representing the price payable by the transferee company for the shares which by virtue of this section that company is entitled to acquire, and the transferor company shall thereupon register the transferee company as the holder of these shares (S. 209 [3]). Any sums so received by the transferor company must be paid into a separate banking account, and the consideration be held in trust for the persons entitled thereto (S. 209 [4]). In this section the expression "dissenting shareholder" includes a shareholder who has not assented to the scheme or contract and any shareholder who has failed or refused to transfer his shares in accordance with the scheme or contract (S. 209 [5]).

Relief from Capital and Transfer Stamp Duty in case of Reconstruction or Amalgamation of Companies.—S. 55, Finance Act, 1927, as amended by S. 31, Finance Act, 1928, and S. 36, Finance Act, 1930, provides relief, subject to certain conditions, from stamp duty on the capital of the company taking over the business.

Conversion of Business into Limited Company.—The advantages accruing from the conversion of a private business into a limited company have already been considered (see p. 262). A company is a separate entity, therefore the conversion must be treated as a sale to an outside party, notwithstanding that no actual change may take place in the management.

The first step in a conversion is to fix the nominal capital for registration. A margin of unissued capital, beyond present needs, should be left for future expansion. The date of the sale, the amount of the goodwill (if any), the advisability of revaluing any of the assets, the payment of the liabilities, the purchase consideration, and the method of its discharge must also be decided. Since *ad valorem* duty will be charged on the book debts, if taken over, it is more usual for the vendors to retain them and to discharge the liabilities. This can be done without disturbing the business, if the new company acts as agent for the vendor in collecting the debts and paying the liabilities. The latest Balance Sheet of the business almost invariably forms the basis for the conversion, subject to any adjustment of book values, or the creation of a Goodwill Account, if deemed desirable.

Illustration.—Messrs. L. and R. Uprichard decide to convert their business into a limited company on December 31, 19.... Profits are shared as to three-fifths and two-fifths respectively. The necessary preliminaries for the formation were taken, and the Company was registered as "Uprichards, Ltd.," to take over the business as on January 1 in the following year. The capital was fixed at 100,000 shares of £1 each. The book values of the assets were accepted by the Company, except that Freehold Property was to be revalued at £38,850 and Patents at £500. The Company was to collect the book debts and pay the liabilities of the old firm. Any difference between these amounts was to be paid in cash by the vendors to the Company. The purchase price of the business was to be satisfied by the allotment of fully paid shares to the vendors. The price of the Goodwill was agreed at £15,000, payable in fully paid shares.

The Book Debts were collected in full and the liabilities satisfied on January 31.

The Balance Sheet of L. and R. Uprichard, as on the date of sale, was as follows:—

L. & R. Uprichard.

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.		£	s.	d.
Capital :—					Freehold Property . . .	35,250	0	0
L. Uprichard .	£36,000				Machinery and Plant . .	10,640	0	0
R. Uprichard .	20,000				Patents	1,500	0	0
		56,000	0	0	Stock	7,760	0	0
Sundry Creditors . . .		10,685	0	0	Sundry Debtors . . .	14,640	0	0
Bills Payable		4,520	0	0	Cash at Bank . . .	1,415	0	0
		£71,205	0	0		£71,205	0	0

Uprichards, Ltd.

6 JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19...								
Dec. 31	Sundry Assets . . . . Dr.							
	To Vendors	13				59,165	0	0
	Freehold Property	1	38,850	0	0			
	Machinery and Plant	3	10,640	0	0			
	Patents	5	500	0	0			
	Stock	7	7,760	0	0			
	Cash at Bank	C.B. 21	1,415	0	0			
	Being assets of the firm taken over at agreed prices per Contract for Sale, dated December 15, 19...							
„ 31	Goodwil Account . . . . . . Dr.	11	15,000	0	0			
	To Vendors	13				15,000	0	0
	Being agreed purchase price of the Goodwill as per Contract for Sale.							
„ 31	Vendors . . . . Dr.	13	74,165	0	0			
	To Share Capital Account	15				74,165	0	0
	Being 74,165 shares of £1 each issued as fully paid in discharge of the purchase price of the business.							

LEDGER.

1 FREEHOLD PROPERTY. 1

Dr. Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Sundries . .	6	38,850	0	0						

LEDGER—*continued.*

MACHINERY AND PLANT.

3 Dr. — Cr. 3

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Sundries	6	10,640	0	0						

PATENTS ACCOUNT.

5 Dr. — Cr. 5

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Sundries	6	500	0	0						

STOCK.

7 Dr. — Cr. 7

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Sundries	6	7,760	0	0						

GOODWILL ACCOUNT.

11 Dr. — Cr. 11

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Vendors	6	15,000	0	0						

VENDORS' ACCOUNT.

13 Dr. — Cr. 13

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Share Capital Account	6	74,165	0	0	19... Dec. 31	By Sundry Assets	6	59,165	0	0
Jan. 31	To Cash— Creditors	21	10,685	0	0	„ 31	„ Goodwill	6	15,000	0	0
	Bills	21	4,520	0	0	Jan. 31	„ Cash *re* Debtors	21	14,640	0	0
						„ 31	„ Cash, Balance due	21	565	0	0
			£89,370	0	0				£89,370	0	0

SHARE CAPITAL ACCOUNT.

15 Dr. — Cr. 15

		J.	£	s.	d.			J.	£	s.	d.
						19... Dec. 31	By Vendors	6	74,165	0	0

CASH BOOK.

21 Dr. — Cr. 21

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance	6	1,415	0	0	19... Jan. 31	By Vendors, Cash paid to Sundry Creditors of old firm	13	10,685	0	0
Jan. 31	„ Vendors, book debts of old firm collected	13	14,640	0	0	„ 31	„ Vendors, Bills Payable met for old firm	13	4,520	0	0
„ 31	„ Vendors, Balance due per agreement	13	565	0	0		„ Balance carried down	√	1,415	0	0
			£16,620	0	0				£16,620	0	0
19... Dec. 31	To Balance brought down.	√	1,415	0	0						

The initial Balance Sheet of the new company would appear as follows:—

Uprichards, Ltd.

BALANCE SHEET, JANUARY 1, 19...

	£	s.	d.		£	s.	d.
Capital :—				Goodwill at cost	15,000	0	0
Nominal : 100,000 shares of £1 each . . £100,000				Freehold Property at cost . .	38,850	0	0
				Machinery and Plant at cost .	10,640	0	0
				Patents at cost	500	0	0
Issued : 74,165 shares of £1 each .	74,165	0	0	Stock	7,760	0	0
				Cash at Bank	1,415	0	0
	£74,165	0	0		£74,165	0	0

The books of the old firm would be closed by means of a Realisation Account as follows:—

18 JOURNAL.

			Dr.			Cr.		
19 ..			£	s.	d.	£	s.	d.
Dec. 31	Realisation Account . . . . . Dr.	14	56,565	0	0			
	To Sundries :—							
	Freehold Property	2				35,250	0	0
	Machinery and Plant	4				10,640	0	0
	Patents	6				1,500	0	0
	Stock	8				7,760	0	0
	Cash at Bank	26				1,415	0	0
	Being book value of the assets sold to the company as per Contract for Sale dated December 15, 19...							
„ 31	Uprichards, Ltd. . . . . . . Dr.	24	74,165	0	0			
	To Realisation Account	14				74,165	0	0
	Being the agreed purchase consideration for sale of the business as per contract dated December 15, 19 ..							
„ 31	Shares in Uprichards, Ltd. . . . . Dr.	16	74,165	0	0			
	To Uprichards, Ltd.	24				74,165	0	0
	Being 74,165 shares of £1 each issued as fully paid in discharge of the purchase price of the business.							
„ 31	Realisation Account . . . . . Dr.	14	17,600	0	0			
	To L. Uprichard	10				10,560	0	0
	„ R. Uprichard	12				7,040	0	0
	Being respective shares of the partners in the profit resulting from the sale of the business.							
„ 31	Sundries Dr.							
	To Shares in Uprichards, Ltd.	16				74,165	0	0
	L. Uprichard	10	46,899	0	0			
	R. Uprichard	12	27,266	0	0			
	For division of the purchase consideration for the sale of the business.							
Jan. 31	Sundry Creditors . . . . . . Dr.	18	10,685	0	0			
	Bills Payable . . . . Dr.	22	4,520	0	0			
	To Uprichards, Ltd.	24				15,205	0	0
	Being sundry liabilities paid by the company as per Contract for Sale.							
„ 31	Uprichards, Ltd. . . . . . . Dr.	24	14,640	0	0			
	To Sundry Debtors	20				14,640	0	0
	Being book debts of the firm collected by the company as per Contract for Sale.							
„ 31	Uprichards, Ltd. . . . . . . Dr.	24	565	0	0			
	To L. Uprichard	10				339	0	0
	„ R. Uprichard	12				226	0	0
	Being cash paid by partners individually in ratio of 3 : 2 to company to discharge excess of liabilities over debtors as per Contract for Sale.							

LEDGER.

2 FREEHOLD PROPERTY. 2

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	✓	35,250	0	0	19... Dec. 31	By Realisation Account . .	18	35,250	0	0

4 MACHINERY AND PLANT. 4

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	✓	10,640	0	0	19... Dec. 31	By Realisation Account . .	18	10,640	0	0

6 PATENTS. 6

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	✓	1,500	0	0	19... Dec. 31	By Realisation Account . .	18	1,500	0	0

8 STOCK. 8

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Balance . .	✓	7,760	0	0	19... Dec. 31	By Realisation Account . .	18	7,760	0	0

10 L. UPRICHARD, CAPITAL ACCOUNT. 10

Dr. Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Shares . .	18	46,899	0	0	19... Dec. 31	By Balance . .	✓	36,000	0	0
						„ 31	„ Share of Profit on Sale of Business	J. 18	10,560	0	0
						Jan. 31	„ Uprichards, Ltd..	18	339	0	0
			£46,899	0	0				£46,899	0	0

12 R. UPRICHARD, CAPITAL ACCOUNT. 12

Dr. Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Shares . .	18	27,266	0	0	19... Dec. 31	By Balance . .	✓	20,000	0	0
						„ 31	„ Share of Profit on Sale of Business	J. 18	7,040	0	0
						Jan. 31	„ Uprichards, Ltd.	18	226	0	0
			£27,266	0	0				£27,266	0	0

LEDGER—*continued.*

14 **Realisation Account.** 1

Dr. Cr.

		J.	£	s.	d.			J.	£	s.
19... Dec. 31	To Sundry Assets .	18	56,565	0	0	19... Dec. 31	By Purchase Price .	18	74,165	0
" 31	" Balance carried down, being profit on sale of the business . .		17,600	0	0					
			£74,165	0	0				£74,165	0
19... Dec. 31	To L. Uprichard, ⅗ths	18	10,560	0	0	19... Dec. 31	By Balance brought down . .	✓	17,600	0
" 31	" R. Uprichard, ⅖ths		7,040	0	0					
			£17,600	0	0				£17,600	0

16 **Shares in Uprichards, Ltd.** 1

Dr. Cr.

		J.	£	s.	d.			J.	£	s.
19... Dec. 31	To 74,165 fully paid shares of £1 each	18	74,165	0	0	19... Dec. 31	By L. Uprichard .	18	46,899	0
						" 31	" R. Uprichard .	18	27,266	0
			£74,165	0	0				£74,165	0

18 **Sundry Creditors.** 1

Dr. Cr.

		J.	£	s.	d.				£	s.
19... Jan. 31	To Uprichards, Ltd. .	18	10,685	0	0	19... Dec. 31	By Balance . .	✓	10,685	0

20 **Sundry Debtors.** 2

Dr. Cr.

			£	s.	d.			J.	£	s.
19... Dec. 31	To Balance . .	✓	14,640	0	0	19... Jan. 31	By Uprichards, Ltd.	18	14,640	0

22 **Bills Payable.** 2

Dr. Cr.

		J.	£	s.	d.				£	s.
19... Jan. 31	To Uprichards, Ltd. .	18	4,520	0	0	19... Dec. 31	By Balance . .	✓	4,520	0

LEDGER—*continued.*

24 UPRICHARDS, LTD. 24

Dr.		J.	£	s.	d.		Cr.	J.	£	s.	d.
19..						19...					
Dec. 31	To Purchase Price .	18	74,165	0	0	Dec. 31	By Fully Paid Shares	18	74,165	0	0
Jan. 31	" Sundry Debtors .	18	14,640	0	0	Jan. 31	" Sundry Creditors	18	10,685	0	0
" 31	" Balance carried down . .	√	565	0	0	" 31	" Bills Payable .	18	4,520	0	0
			£89,370	0	0				£89,370	0	0
19...						19...					
Jan. 31	To Sundries . .	18	565	0	0	Jan. 31	By Balance brought down . .	√	565	0	0

CASH BOOK.

26 26

Dr.			£	s.	d.		Cr.	J.	£	s.	d.
19...						19...					
Dec. 31	To Balance . .	√	1,415	0	0	Dec. 31	By Realisation Account . .	18	1,415	0	0

Where an arrangement is made for the purchasing company to collect the debts and pay the liabilities, as agent for the vendors, it is undesirable for the company to enter these items in their books, except by way of memoranda, until cash has passed. Separate columns may be kept in the Cash Book, or a separate Cash Book be used, to record the receipts and payments on behalf of the vendors, the individual items being posted to the old personal accounts, handed over for the purpose. The totals can be posted periodically to the vendors' account, thus showing the balance due to or from them. Bad Debts and Discounts, allowances, etc., are thus automatically adjusted through the vendors' account, and the books of the company itself show the true position, *i.e.* that they are doing something for the vendors, with whom they have a personal account. The entries set out on pp. 474–479 are those which should theoretically be made in the two sets of books. In practice, however, in a case where the business continues unchanged except in its legal form and the shareholders in the company are the same persons as the previous partners, it is probable that the same set of double-entry books will be continued in use. Since the assets and liabilities will for the most part be unaffected by the change of constitution it would be permissible in such a case to save some time and labour by making a " short cut," making no entries in those accounts which under the new constitution open with the same balances as the original balances in the ledger. It is clear, for instance, that no one would dream of closing all the accounts in the Purchases and Sales Ledgers and opening new ledgers for these, and the same principle may be extended to the asset accounts in the nominal Ledger. In such a case the books are regarded as a record of the transactions of the business (as a whole), including those arising both before and after the conversion. The old Cash Book must, of course, be balanced off and closed, and a new one opened, but this will probably be in the original book; apart from this the only ledger accounts which are necessarily affected, and in which entries *must* be made, are those dealing with the partners' capital and current accounts and the like on the one hand, and the company's share capital on the other.

Dealt with in this way, the entries recording the conversion illustrated on p. 474 but assuming that the debtors and creditors were taken over by the company and that no cash was paid to or by the partners, would be as follows:—

L. & R. Uprichards and Uprichards, Ltd.

6

JOURNAL.

			Dr. £	s.	d.	Cr. £	s.	d.
19... Dec. 31	Sundry Assets. Dr.							
	To Conversion Account	4				18,600	0	0
	,, Freehold Property	1	3,600	0	0			
	,, Goodwill	3	15,000	0	0			
	Book value of assets written up on conversion to limited company.							
,, 31	Conversion Account . Dr.	4	1,000	0	0			
	To Patents	2				1,000	0	0
	Book value of patents written down.							
,, 31	Company's Bank Account . Dr.	C.B. 22	1,415	0	0			
	To Firm's Bank Account	C.B. 21				1,415	0	0
,, 31	Conversion Account . Dr.	4	17,600	0	0			
	To L. Uprichards	5				10,560	0	0
	,, R. Uprichards	6				7,040	0	0
	Book profit on conversion shared between the partners in their profit-sharing ratio.							
,, 31	Partners' Capital Accounts Dr.							
	L. Uprichards	5	46,560	0	0			
	R. Uprichards	6	27,040	0	0			
	To Share Capital	7				73,600	0	0
	Shares issued in satisfaction for transfer of net assets.							

LEDGER.

1 **FREEHOLD PROPERTY.** 1

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance	√	35,250	0	0						
,, 31	,, Conversion Account	J. 6	3,600	0	0						
			£38,850	0	0						

2 **PATENTS.** 2

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Balance	√	1,500	0	0	19... Dec. 31	By Conversion Account	J. 6	1,000	0	0
						,, 31	,, Balance carried down		500	0	0
			£1,500	0	0				£1,500	0	0

LEDGER—*continued.*

3 GOODWILL. 3

Dr. Cr.

			£	s.	d.				£	s.	d.
19... Dec. 31	To Conversion Account	J. 6	15,000	0	0						

4 CONVERSION ACCOUNT. 4

Dr. Cr.

		J.	£	s.	d.			J.	£	s.	d.
19... Dec. 31	To Patents	6	1,000	0	0	19... Dec. 31	By Sundries	6	18,600	0	0
" 31	" L. Uprichards	6	10,560	0	0						
" 31	" R. Uprichards	6	7,040	0	0						
			£18,600	0	0				£18,600	0	0

5 L. UPRICHARDS, CAPITAL ACCOUNT. 5

Dr. Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Share Capital	6	46,560	0	0	19... Dec. 31	By Balance	√	36,000	0	0
						" 31	" Conversion Account	J. 6	10,560	0	0
			£46,560	0	0				£46,560	0	0

6 R. UPRICHARDS, CAPITAL ACCOUNT. 6

Dr. Cr.

		J.	£	s.	d.				£	s.	d.
19... Dec. 31	To Share Capital	6	27,040	0	0	19... Dec. 31	By Balance		20,000	0	0
						" 31	" Conversion Account	J. 6	7,040	0	0
			£27,040	0	0				£27,040	0	0

7 SHARE CAPITAL. 7

Dr. Cr.

			£	s.	d.			J.	£	s.	d.
						19... Dec. 31	By Sundries	6	73,600	0	0

The initial Balance Sheet of Uprichards, Ltd., would be as follows:—

BALANCE SHEET, JANUARY 1, 19...

	£	s.	d.		£	s.	d.
Capital:— *Nominal:* 100,000 shares of £1 each £100,000 *Issued and Fully Paid:* 73,600 shares of £1 each	73,600	0	0	Goodwill	15,000	0	0
Sundry Creditors	10,685	0	0	Freehold Property	38,850	0	0
Bills Payable	4,520	0	0	Machinery and Plant	10,640	0	0
				Patents	500	0	0
				Stock	7,760	0	0
				Sundry Debtors	14,640	0	0
				Balance at Bank	1,415	0	0
	£88,805	0	0		£88,805	0	0

Profits Prior to Incorporation.—When a limited company is registered in order to purchase an established business, it is necessary to fix a definite date when the undertaking is to be taken over. If that date is after the incorporation of the company, no difficulty arises. The agreed date of purchase, however, is usually that upon which the last accounts of the business were prepared. The prospectus of the new company will then state, *e.g.* "That the business of B. Blank & Sons will be taken over by the company as on January 1, 19..." It will be clear that a period of time may elapse between that date and the date of incorporation of the company owing to the time required for carrying out the necessary formalities for the formation and registration of the new company. That being so, there must be two periods during which profits are being earned, viz. (*a*) prior to incorporation, and (*b*) subsequent to incorporation. The company does not exist until it has been legally incorporated, and obviously until it is incorporated it cannot earn profits. It follows, therefore, that the profits earned anterior to incorporation are of a capital nature, and not available for division, since the company, in law, takes over the assets on the date of incorporation, in such a case, not on an earlier date. Any profits earned prior to that date result in an increase of assets, which are taken over *as assets, i.e.* they are taken as capital.

In view of these facts, it becomes necessary to apportion the profits between these two periods, and that portion which accrued prior to incorporation should be used to reduce the purchase price of the business. Goodwill, if any, suggests itself as the most suitable item for reduction. Failing this, Land and Buildings, or similar fixed asset, should be credited with the amount available. If there are no assets that can be suitably reduced, the amount should be taken to a Capital Reserve Account.

Undoubtedly, the best course to pursue would be to take stock and prepare accounts for the two periods. But, in the majority of cases, the preparation of two sets of accounts, and a double stock-taking, would prove too great and too expensive a task. An approximate apportionment of the profits as between the two periods is the usual compromise. Circumstances, and the nature of the business, must suggest the equitable basis for the apportionment. Where profits are evenly earned during the year, a time basis, though not very scientific, is reasonable. But a time basis would not be justified in cases where the trade is a "season" trade, or varies greatly month by month. In such cases, the special circumstances must be taken into account.

A method frequently adopted is to apportion the gross profit on the turnover of the whole period between the two periods, and to credit each period with the proportion of the gross profit on the sales belonging to it. The gross profit thus arrived at is debited with the charges set out in the Profit and Loss Account, apportioned on a time basis, or as they were actually incurred during the two periods, if such treatment is reasonable. In most cases, it is probably more scientific to confine apportionments on the "time" basis to standing charges which do not vary with the turnover, treating all other items on their individual merits.

Objections can be raised to both methods, but they are approximate enough for practical purposes.

Illustration 1.—Dicksons, Ltd., was incorporated on March 31, 19..., and acquired the business of Abel Chatenay as from the previous January 1. The accounts of the company at the close of the first year to December 31 disclosed the following results:—

	£
Gross Profit for the year	40,000
Sundry Profit and Loss Charges and Expenses . . .	8,000
Managing Director's Salary, Directors' Fees, and other charges applicable to the company only	4,200
Sales for the year	400,000
Sales, January 1 to March 31	80,000
Sales, April 1 to December 31	320,000
Net Profit for the year	30,220

The percentage of gross profit remained unchanged throughout the year. For the period January 1 to March 31 the proportion of gross profit

$$= \frac{80{,}000}{400{,}000} \text{ of } £40{,}000 = £8{,}000.$$

For the period April 1 to December 31 the proportion of gross profit

$$= \frac{320{,}000}{400{,}000} \text{ of } £40{,}000 = £32{,}000.$$

The apportionment of the profits as between the two periods will then be arrived at as follows:—

THE LIMITED COMPANY'S PERIOD, MARCH 31 TO DEC. 31, 19...

	£	s.	d.		£	s.	d.
To Proportion of Profit and Loss Expenses	6,000	0	0	By Share of Gross Profit . . .	32,000	0	0
„ Expenses wholly applicable to the company	4,200	0	0				
„ Balance, being profit available for division . . .	21,800	0	0				
	£32,000	0	0		£32,000	0	0

The net profit of the complete year is £30,220, and the proportion applicable to the Limited Company as shown above is £21,800. There therefore remains £8,420, representing the capital profit which accrued prior to the incorporation of the company. As explained above, this sum is available in reduction of some suitable asset, or as a Capital Reserve.

Illustration 2.—Blanks, Ltd., was incorporated on March 31, 19..., to acquire the old-established business of Uprichards & Son as on January 1 of the same year. The sales for the complete year to December 31 were £80,000; the sales to March 31 were £20,000; the sales from April 1 to December 31 being £60,000. The net profit for the year was £20,000.

The Capital Profit (January 1 to March 31) was therefore:—

$$\frac{20{,}000}{80{,}000} \text{ of } £20{,}000 = £5{,}000.$$

The profit available for distribution (March 31 to December 31) was:—

$$\frac{60{,}000}{80{,}000} \text{ of } £20{,}000 = £15{,}000.$$

In the case of a manufacturing company, it may be advisable to base the apportionment of the profit between the two periods according to the volume and value of the sales. It may also be necessary, in such a case, to charge each period, as far as possible, with the various debts and charges properly applicable to them. In this connection a statement should be prepared as under:—

APPORTIONMENT OF PROFITS FOR THE YEAR ENDED ....

	Prior to Incorporation.	Subsequent to Incorporation.		Prior to Incorporation.	Subsequent to Incorporation.
	£ s. d.	£ s. d.		£ s. d.	£ s. d.
Salaries, Management Charges, General Charges and Depreciation . .	23,060 0 0	7,041 0 0	Gross Profit (based upon sales) .	33,620 0 0	18,480 0 0
Bad Debts . .	1,020 0 0	200 0 0			
Interest on Debentures . . .		2,300 0 0			
Directors' Fees, and Secretary's Salary .		1,525 0 0			
Advertising . .	1,645 0 0	2,480 0 0			
Balance carried down	7,895 0 0	4,934 0 0			
	£33,620 0 0	18,480 0 0		£33,620 0 0	18,480 0 0
			By Balance brought down . .	7,895 0 0	4,934 0 0

The profit applicable to the first period, as shown in the above statement (£7,895), would be carried to Reserve; the profit for the second period (£4,934) being available for distribution.

Loss Prior to Incorporation.—The author has known a purchasing company to be so unfortunate as to experience a loss on trading for the period prior to incorporation. The effect of such a loss is to increase the purchase price of the business, and the amount of the loss must be added to a suitable asset account (*e.g.* Goodwill Account), or, preferably, be taken to a Suspense Account to be dealt with when profits become available for its reduction.

Valuation of Shares.—The Articles of private companies frequently provide that, in case of need, the shares are to be valued by the auditors of the company. Such a valuation may become necessary: (*a*) upon the death of a shareholder, (*b*) should any member desire to dispose of his holding. In the latter case, the Articles of the majority of private companies restrict the offer of shares, in the first place, to existing members of the company. The usual bases for the valuation of shares are: (1) the profit basis, (2) the asset basis as disclosed by the Balance Sheet.

(1) *Profit Basis.*—The average annual profits for from three to five years are ascertained and capitalised, and increased by any Reserve or other fund accumulated out of profits prior to inclusion in the ascertained average.

Illustration.—Blanks, Ltd., have an issued capital £20,000, and a Reserve Fund of £4,000 representing undivided profits. The average profits for the past five years amount to £4,000. It is assumed that in a business of the type carried on by the company an investor in its ordinary shares would look for a return of 10%. The average annual profits on this basis capitalise at £40,000, plus the reserve of £4,000, or £44,000 in all. The value of the 20,000 shares may therefore be taken at £2 4s. per share.

(2) *Asset Basis.*—This rests upon the value of the assets in which the capital is invested, as disclosed in the Balance Sheet. By this method the question to be answered is: What funds would be available for the shareholders after all possible claims against the company have been settled?

Illustration.—The following is the Balance Sheet of Rayon d'Or, Ltd.:—

BALANCE SHEET.

	£	s.	d.		£	s.	d.
Capital :—				Goodwill	4,000	0	0
Issued : 20,000 shares of £1 each, fully paid	20,000	0	0	Sundry Assets	37,000	0	0
5% Debentures	10,000	0	0	Cash	3,000	0	0
Reserve Account	4,000	0	0				
Sundry Creditors	9,000	0	0				
Profit and Loss Account (Balance).	1,000	0	0				
	£44,000	0	0		£44,000	0	0

The Articles provide that Goodwill Account is to be revalued periodically on the basis of two years' purchase of the average annual profits for the four years following the last valuation, and that any appreciation or depreciation in the asset is to be adjusted through the Reserve Account. On this basis of valuation just taken, the goodwill of Rayon d'Or, Ltd., is found to be worth £3,000. Assuming that the remaining assets are of the value stated in the Balance Sheet, and that no other liabilities exist, it would appear that the shareholders are entitled to:—

	£	£
Capital		20,000
Reserve Account	4,000	
Less Depreciation in value of Goodwill . .	1,000	
		3,000
Profit and Loss Account		1,000
Total Net Assets		£24,000

On this basis the shares may be taken to be worth £1 4*s*. per share.

The student must understand that the above illustrations deal with the question of valuation in its simplest form. In most actual cases, other considerations must be taken into account, *e.g.* (*a*) the nature of the security afforded by the assets; (*b*) the prospects of a steady return of income from the shares; (*c*) whether the death or retirement of the shareholder will prejudice the earning capacity of the company; (*d*) the adequacy of the reserves; (*e*) the nature of the secret reserves (if any); (*f*) the inclusion of fictitious assets in the Balance Sheet; (*g*) what rights attach to the Preference Shares, cumulative and non-cumulative; (*h*) whether there are any arrears of dividend, or any unissued Preference Shares, or any special market considerations that may affect the company's future prospects, and so forth.

Valuing Unquoted Shares.—The accountant is not infrequently called upon to value unquoted shares in private and public companies for probate purposes. The bases of valuation outlined above are equally suitable for such purposes. No definite Inland Revenue rules are laid down for such valuations. The market price of the shares for probate purposes must be "the price which, in the opinion of the Commissioners of Inland Revenue, the shares would fetch if sold in the open market on the terms that the purchaser should be entitled to be registered as the holder of the shares" (*Re Henry Jameson, deceased: Attorney-General* v. *Jameson and others,* [1905]). It must be noted that, for Estate Duty purposes, an *open market* for the shares must be assumed to exist in the terms of Sec. 7 (5), Finance Act, 1894, as interpreted by the rule laid down in the case quoted above, notwithstanding that a company may have Articles restricting the sale of its shares.

Annual Report and Accounts.—Every company *must* keep proper books of account with respect to:—

(*a*) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place;

(*b*) all sales and purchases of goods by the company;

(*c*) the assets and liabilities of the company (S. 147 [1]).

Sub-section (2) (in the 1948 Act for the first time) makes some attempt to define "proper books of account" by saying "proper books of account shall not be deemed to be kept . . . if there are not kept such books as are necessary to give a true and fair view of the state of the company's affairs and explain its transactions." The books must be kept at the registered office "or at such other place as the directors think fit," and must at all times be open to inspection by the directors (S. 147 [3]): if books of account are kept outside Great Britain (as normally with companies operating abroad) such accounts and returns must be sent to Great Britain at intervals of not more than six months as are necessary to disclose the financial position "with reasonable accuracy."

If any person being a director of a company fails to take all reasonable steps to secure compliance by the company with the above requirements, or has by his own wilful act been the cause of any default by the company thereunder, he is, in respect of each offence, liable on summary conviction to imprisonment for a term not exceeding six months, or to a fine not exceeding £200. Imprisonment is only to be imposed where the Court considers that the offence was committed wilfully (S. 147 [4]).

Moreover, by S. 331, if where a company is wound up it is shown that proper books of account were not kept by the Company throughout the period of two years immediately preceding the commencement of the winding-up, every director, manager, or other officer who was knowingly a party to or connived at the default of the company shall, unless he shows that he acted honestly or that in the circumstances in which the business of the company was carried on the default was excusable, be liable on conviction on indictment to imprisonment for a term not exceeding one year, or on summary conviction to imprisonment for a term not exceeding six months. For the purposes of this section, proper books of account shall be deemed not to have been kept in the case of any company if there have not been kept such books or accounts as are necessary to exhibit and explain the transactions and financial position of the trade or business of the company, including books containing entries from day to day in sufficient detail of all cash received and cash paid, and, where the trade or business has involved dealings in goods, statements of the annual stocktakings and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing the goods and the buyers and sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified.

From an examination of the above statutory provisions, it will be obvious that every company must keep adequate books of account, and that only by means of a complete set of books on the double-entry system can such adequacy be assured.

Profit and Loss Account and Balance Sheet.—The directors must at some date not later than eighteen months after the incorporation of the company and subsequently once at least in every calendar year lay before the company in general meeting a Profit and Loss Account or, in the case of a company not trading for profit, an Income and Expenditure Account for the period, in the case of the first account, since the incorporation of the company, and, in any other case, since the preceding account, made up to a date not earlier than the date of the meeting by more than nine months, or, in the case of a company carrying on business or having interests abroad, by more than twelve months. The Board of Trade may, if they think fit for any special reason, extend these periods (S. 148 (1)).

The directors must cause to be made out in every calendar year, and to be laid before the company in general meeting, a Balance Sheet as at the date to which the Profit and Loss Account (or Income and Expenditure Account, if appropriate) is made up (S. 148 (2)).

It has already been stated that a copy of the Balance Sheet and relevant documents must form part of the Annual Return to be registered with the Registrar (S. 127) by all companies other than exempt private companies (exempted under certain conditions by S. 129). Assurance companies are also exempted from this requirement provided they have complied with the Assurance Companies Act, 1909, S. 7 (4).

Directors' Report.—There must be attached to every Balance Sheet laid before the company in general meeting as mentioned above, a report by the directors with respect to (*a*) the state of the company's affairs, (*b*) the amount, if any, which they recommend should be paid by way of dividend, and (*c*) the amount, if any, which they propose to carry to reserves within the meaning of the Eighth Schedule (*i.e.* reserves as distinct from provisions) (S. 157 (1)). The report must also deal "so far as is material for the appreciation of the state of the company's affairs by its members and will not in the opinion of the

rectors be harmful to the business of the company" (*e.g.* by dis-
osing confidential information to competitors or persons with whom
ntracts may be in course of negotiation) with "any change during
e year in the nature of the company's business" or "in the classes
business in which the company has an interest" (S. 157 [2]).

Most companies combine a copy of their annual accounts with the
tice convening the Annual General Meeting and the Directors'
eport on the Accounts. Page 1 of the folder contains the Report;
ge 2, the Profit and Loss Account and Balance Sheet; and the notice
nvening the meeting appears as an indorsement. Nowadays,
irectors' Reports tend to extreme brevity, and are usually confined to:
) A short summary of the year's trading, with or without comparison
ith previous years; (*b*) a statement showing the balance available
r distribution, and its proposed allocation; (*c*) the names of the
tiring Directors and Auditors, and the fact that they are eligible for
d desire re-election. The usual character of these documents may
gathered from the subjoined specimen, which is an actual report
cept for the substitution of imaginary names. It is not uncommon
so to circulate with the report a print of the speech which the chair-
an intends to make at the annual general meeting. This has a
uble object: (*a*) it saves the postage which would be incurred if the
int were sent separately after the meeting, and (*b*) it may possibly
swer a question which a member might think it worth while attend-
g the meeting to ask, thus making the trouble of attendance un-
cessary.

(*Typical Directors' Report.*)

anks, Ltd.

DIRECTORS:

A. B. (*Chairman*).
C. D. (*Managing Director*).
E. F. (*Assistant Managing Director*).
G. H., I. K., L. M.

SECRETARY AND REGISTERED OFFICE:

W. H. Bury, 1, High Street, Blanktown.

AUDITORS:

Abel Checker & Co., Chartered Accountants, 99, Cross Street, Blanktown.

BANKERS:

The Blanktown Bank.

NOTICE is hereby given that the 34TH ANNUAL GENERAL MEETING of the
ove-named Company will be held at 1, High Street, Blanktown, on Wednesday
e 17th day of November, 1948, at 11.30 a.m., for the purpose of transacting the
llowing business:—

1. To receive the Accounts for the twelve months ended 31st March, 1948, and the Report of the Directors and Auditors, thereon.
2. To confirm the payment of Dividends on the Preference Shares, and the Interim Dividends on the Ordinary Shares, for the year ended 31st March, 1948.
3. To elect a Director. Mr. G. H. retires and offers himself for re-election.

4. To appoint Auditors for the ensuing year. Messrs. Abel Checker & Co., Chartered Accountants, retire and offer themselves for re-election.

5. To fix the Auditors' Remuneration for the year to 31st March, 1949.

6. To transact such other business as may be properly transacted at the Annual General Meeting.

Dated this 25th day of October, 1948.
ON BEHALF OF THE BOARD,
W. H. Bury, Secretary.

1, High Street,
Blanktown.

N.B.—A Member entitled to attend and vote is entitled to appoint a Proxy to attend and vote instead of him, and that Proxy need not also be a member.

Blanks, Ltd.

REPORT OF THE DIRECTORS TO THE SHAREHOLDERS.

The Directors report that the state of the Company's affairs is satisfactory and s fully dealt with in the Chairman's Statement circulated with these accounts.

1947. £		£
546,110	Profit before Taxation	688,083
	Deduct Provision for Taxation on the Profits of the year:	
206,524	Profits Tax	152,256
159,153	Income Tax	265,014
180,433	Profits after Taxation	270,813
124,539	Balances at credit of Profit and Loss (Appropriation Accounts at beginning of year)	163,053
304,972	Leaving a Balance of	433,866
	which the Directors recommend be disposed of as follows:—	
20,000	Staff Pensions Reserve	28,422
	Dividends:—	
6,419	Preference	10,012
	Ordinary:	
57,750	First Interim paid 20th February, 1948	67,375
57,750	Second Interim paid 11th September, 1948	67,375
63,053	Leaving a Balance to carry forward of	£260,682

Contents of Balance Sheet.—The Balance Sheet must exhibit the llowing information:—

(i) A summary of the authorised share capital.

(ii) A summary of the issued share capital.

(iii) A summary of the liabilities.

(iv) A summary of the assets.

(v) Such particulars as are necessary to disclose the general ature of the liabilities and assets, and to distinguish between the mounts respectively of the fixed assets and of the floating assets.

(vi) A statement of how the values of the fixed assets have been rrived at.

(vii) A statement under separate headings, so far as they are not ritten off, of—

(*a*) The preliminary expenses of the company;

(*b*) Any expenses incurred in connection with any issue of shares or debentures:

(c) If it is shown as a separate item in or is otherwise ascertainable from the books of the company, or from any contract for the sale or purchase of any property to be acquired by the company, or from any documents in the possession of the company relating to the stamp duty payable in respect of any such contract or the conveyance of any such property, the amount of the goodwill and of any patents and trade-marks as so shown or ascertained.

(viii) Where any liability is secured otherwise than by operation of law on any assets of the company, a statement that that liability is so secured, but it is not necessary to specify the assets on which the liability is secured (S. 124).

(ix) The aggregate holding of shares in subsidiary companies; and the aggregate indebtedness from such companies and to such companies (S. 125) (see p. 529).

(x) Capital Redemption Reserve Fund created on the redemption of Redeemable Preference Shares.

(xi) Details of Redeemable Preference Shares and the date on or before which they are, or are to be liable to be redeemed (S. 46).

(xii) So far as it has not been written off, the commission paid in respect of any shares or debentures and any discount on debentures (S. 44), and discount on shares issued at a discount (S. 47).

(xiii) Share capital on which and rate at which interest during construction, etc., has been paid out of capital under S. 54. (This *might* appear in the Profit and Loss Account, but is better shown in the Balance Sheet.)

(xiv) Redeemed Debentures available for re-issue (S. 75 [3]).

(xv) Amount of loans for the purchase of fully paid shares in accordance with a scheme for such purchase by Trustees for the benefit of employees, or to employees to purchase shares for their own beneficial ownership (S. 45).

(xvi) Any Reserve, General Reserve, or Reserve Fund which the Directors' Report specifies (S. 123 [2]).

Either the Balance Sheet or the Profit and Loss Account must also isclose:—

(xvii) The amount of any loans made during the period of the accounts to any Director or Officer, including loans repaid during the period, and the amount of any loans previously made and still outstanding, unless the loans were made by a moneylending company (*e.g.* a bank) in the ordinary course of business, or the loan is to an employee and does not exceed £2,000 and is certified by the directors to be in accordance with the company's practice in respect to such loans (S. 128).

(xviii) The total of the amount paid to directors as remuneration for their services by the company or any subsidiary company (excluding the managing director and any sums paid in respect of other offices held by directors) (S. 128).

For outline of a Balance Sheet see pp. 497–504.

Signing of Balance Sheet, etc.—The Balance Sheet must be signed on behalf of the board by two of the directors, or by the sole director (S. 155 [1]). The Profit and Loss Account (together with group accounts, if any, to be laid before the members) must be approved by the board (S. 156 [2]) (though they are not signed) and attached to the Balance Sheet, together with the Auditors' Report (S. 156 [1]). The Auditors' Report must be read before the company in general meeting and be open to inspection by any member (S. 162 [2]).

Circulation of Accounts.—A copy of every Balance Sheet which is o be laid before the company in general meeting, together with every document required by law to be annexed thereto" (which neans a Profit and Loss Account and, where the company is a holding ompany, group accounts) and a copy of the Auditors' Report, must, ot less than twenty-one days before the date of the meeting, be sent o every member of the company and to every debenture holder S. 158 [1]). This applies whether or not the individual in question is ntitled to attend the meeting, and therefore includes Preference hareholders and members of all private, as well as public companies. rior to 1948 it was sufficient to circulate the accounts seven days efore the meeting, and only members entitled to notice of meetings ere entitled to copies of the accounts: in the case of a private company en the ordinary members did not receive copies automatically, but ch a member could demand a copy on payment of a charge not ceeding sixpence per hundred words.

Profit and Loss Account.—The statement prepared to determine e net profit or revenue, or the net loss, as the case may be, for the riod covered by the account, is, with the great majority of commercial nited Companies, termed the Profit and Loss Account. Assurance mpanies, companies working under the double-account system, and me Trust, Finance, and Land Companies employ the term "Revenue count."

The construction of these accounts has been fully discussed in apter III, and three model solutions to company examination estions demanding the preparation of Trading and Profit and Loss counts, and Balance Sheet, will be found on pp. 497–504. The dent must understand, however, that it is a rare experience to find the published accounts of companies anything like the detail given these worked examples. It is exceptional for a limited company to blish a Trading or Manufacturing Account. The Profit and Loss count as usually published gives very little, if anything, more than minimum statutory information. It is almost always divided into sections, the second of which (though not generally so called in published accounts) is what the reader has become accustomed to the Appropriation Account or Appropriation Section of the Profit Loss Account. In the first section there will be shown on the dit side dividends and interest received, possibly transfer fees, and receipts (if substantial in amount) of an exceptional nature: on debit side, depreciation, debenture interest, directors' remuneration, etimes the auditors' remuneration (always if disclosure is necessary nder the Eighth Schedule, para. 13), and occasionally such items as gal charges or registrars' charges. In the Appropriation Section will e found the balance brought forward from last year, charges for xation, transfers to reserves, and dividends paid or recommended. he "gross profit" shown in these accounts is usually arrived at as xplained below. If the *true* gross profit is brought down, then the hole of the General Expenses are debited here in one total.

A specimen of a published Profit and Loss Account is shown on . 493.

Appropriation Account.—It is particularly necessary to prepare is section of the Profit and Loss Account in the case of limited companies, since, otherwise, the account will not show at a glance the net sult of the year's working. Some students, when answering company xamination exercises, present the Profit and Loss Account in one ontinuous account, and include in it the balance brought from last ear, and any dividends that may have been paid. Marks are lost by is treatment, which fails to show the profit for the current year, or o differentiate between charges against profits and appropriations om profits.

The method recommended is: Carry the net profit or loss for the urrent year to the appropriate section; increase or diminish this sum y the balance brought forward from last year; debit all dividends, hether paid or proposed (but being careful to distinguish, as regards ach such item, whether it is paid or merely proposed); any transfers o Reserve; any amounts written off goodwill; Directors' or Managing irectors' Commission on net profits; income tax chargeable on rofits, and similar items; all of which are appropriations out of rofits and not charges against them.* The final balance of the ection will show the amount of undistributed profit to be carried orward.

Illustration.—Uprichards, Ltd., has an issued capital of £200,000 7% Preference Stock and 200,000 Ordinary Shares of £1 each, all fully paid. The balance of profit for the current year (ended December 31, 19.1), *after* deducting the half-year's preference dividend paid to June 30, 19.1, amounted to £55,798, and the balance brought forward from the previous year was £11,892.

The directors made the following recommendations:—

	£
To provide for income tax	25,100
To transfer to General Reserve, making that account up to £50,000 .	10,000
To write off the balance of Debenture Issue Expenses Account . .	3,975
To pay the half year's dividend to December 31 on the Preference Shares, less tax	3,850
To pay a dividend of 5% free of tax on the Ordinary Shares . .	10,000
And to carry forward the balance to next year.	

These recommendations were approved at the Annual General Meeting held on March 16, 19.2. The dividend warrants were posted on the following day, the corresponding amounts being transferred at the same time from the main bank account to special Dividend Bank Accounts on which the warrants were drawn. Three months later the balance on the Preference Dividend

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* Commissions are, of course, chargeable against profits for the purposes of axation. We are not here concerned with this aspect.

(*Typical Profit and Loss Account, as published by Limited Companies.*)

Uprichards, Ltd.

(STATUTORY) PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19.2

19.1		£	s.	d.	£	s.	d.	19.1		£	s.	d.
2,380	To Depreciation of Buildings and Plant				2,610	0	0	12,473	By Trading Profit for the year	14,559	0	0
	,, Directors' Remuneration :—							3	,, Transfer Fees	2	0	0
250	Fees	250	0	0				120	,, Interest on Investments, gross	120	0	0
1,500	Management Remuneration	1,650	0	0	1,900	0	0	—	,, Profit on maturity of Leasehold Redemption Policy	308	0	0
105	,, Auditors' Fees				105	0	0					
400	,, Interest on Debentures				400	0	0					
7,961	,, Balance carried down				9,974	0	0					
£12,596					£14,989	0	0	£12,596		£14,989	0	0
1,000	To Transfer to General Reserve				1,000	0	0	2,216	By Balance brought forward from last year	2,407	0	0
	,, Taxation on the current year's profits :—							7,961	,, Net Profit for the current year brought down	9,974	0	0
1,530	Profits Tax	1,880	0	0								
2,710	Income Tax	3,160	0	0	5,040	0	0					
	,, Dividends paid and proposed, less tax at 9s. :—											
330	On £10,000 6% Cumulative Preference Stock, paid	330	0	0								
1,100	On 50,000 Ordinary Stock Interim 4%; paid	1,100	0	0								
1,100	Final 6% proposed	1,650	0	0	3,080	0	0					
2,407	,, Balance carried forward to next year				3,261	0	0					
£10,177					£12,381	0	0	£10,177		£12,381	0	0

Notes.—(1) It will be seen that the "Trading Profit" is neither the gross profit for the year nor the net profit, but a figure arrived at by deducting from the gross profit all expenses other than those actually set out in the published account and adding discounts and the like.

(2) Comparative figures for the previous year are shown in the left-hand margin, the usual method.

(3) Shillings and pence are not shown, again the normal modern practice. Where the item in the company's books includes an odd amount of less than ten shillings it is normally "rounded down" to the nearest £ below, where more than ten shillings it is "rounded up" to the nearest £ above: sometimes, however, the strict application of this rule will not allow the sides to balance (a little experimenting will show the reader why) and to correct this one or two figures may have to be adjusted the "wrong way."

(4) A single figure for the charge for depreciation is shown, without disclosing its allocation between the different types of fixed asset. This is the "minimum" requirement.

(5) Observe that, in compliance with the Eighth Schedule, para 14 (4) it is specifically stated that the dividends are "less tax."

Bank Account (representing warrants not presented) amounted to £165 and the balance of the Ordinary Dividend Bank Account to £180. Assume that the standard rate of income tax is 9s. in the £.

The entries in the company's books are as follows:—

prichards, Ltd.

LEDGER.

PROFIT AND LOSS ACCOUNT. 1

(Appropriation Section.)

DR. CR.

			£	s.	d.				£	s.	d.
19.1 ec. 31	To Provision for Income Tax . .		25,100	0	0	19.1 Dec. 31	By Balance from last year . . .		11,892	0	0
,, 31	,, General Reserve .		10,000	0	0		,, Balance brought down . .		55,798	0	0
,, 31	,, Debenture Issue Expenses written off . . .		3,975	0	0						
,, 31	,, Preference Dividend paid for the half year to Dec. 31 less tax . .		3,850	0	0						
,, 31	,, Dividend on Ordinary Shares free of tax . . .		10,000	0	0						
,, 31	,, Balance carried down .		14,765	0	0						
			£67,690	0	0				£67,690	0	0
						19.2 Jan. 1	By Balance brought down . .		14,765	0	0

DEBENTURE ISSUE EXPENSES ACCOUNT. 3

DR. CR.

			£	s.	d.				£	s.	d.
19.1 ec. 31	To Balance . .	√	3,975	0	0	19.1 Dec. 31	By Profit and Loss Account . .	1	3,975	0	0

GENERAL RESERVE. 5

DR. CR.

			£	s.	d.				£	s.	d.
						19.1 Dec. 31	By Balance . .	√	40,000	0	0
						,, 31	,, Profit and Loss Account . .	1	10,000	0	0
									£50,000	0	0

PREFERENCE DIVIDEND ACCOUNT NO. 37. 7

DR. CR.

			£	s.	d.				£	s.	d.
19.2 an. 17	To Preference Dividend Bank Account .	15	3,685	0	0	19.1 Dec. 31	By Profit and Loss Account . .	1	3,850	0	0

ORDINARY DIVIDEND ACCOUNT NO. 19. 9

DR. CR.

			£	s.	d.				£	s.	d.
19.2 une 17	To Ordinary Dividend Bank Account .	17	9,820	0	0	19.1 Dec. 31	By Profit and Loss Account . .	1	10,000	0	0

LEDGER—*continued.*

INCOME TAX ACCOUNT.

I — 11

Dr. — Cr.

			£	s.	d.				£	s.	d.
						19.1 Dec. 31	By Balance (assumed)	√	2,960	0	0
						„ 31	„ Profit and Loss Account	1	25,100	0	0
									£28,060	0	0

MAIN CASH BOOK.

3 — 13

Dr. — Cr.

			£	s.	d.				£	s.	d.
19.2 ar. 17	To Balance (assumed)	√	23,651	0	0	19.2 Mar. 17	By Preference Dividend Bank Account No. 37	15	3,850	0	0
						„ 17	„ Ordinary Dividend Bank Account No. 19	17	10,000	0	0
						„ 17	„ Balance carried forward	√	9,801	0	0
			£23,651	0	0				£23,651	0	0

PREFERENCE DIVIDEND BANK ACCOUNT NO. 37.

15

Dr. — Cr.

			£	s.	d.				£	s.	d.
19.2 r. 17	To Main Cash Book .	13	3,850	0	0	19.2 June 17	By Preference Dividend Account 37	7	3,685	0	0
						„ 17	„ Balance carried forward	√	165	0	0
			£3,850	0	0				£3,850	0	0

ORDINARY DIVIDEND BANK ACCOUNT NO. 19.

17

r. — Cr.

			£	s.	d.				£	s.	d.
.2 . 17	To Main Cash Book .	13	10,000	0	0	19.2 June 17	By Ordinary Dividend Account 19	9	9,820	0	0
						„ 17	„ Balance carried forward	√	180	0	0
			£10,000	0	0				£10,000	0	0

The above Ledger Accounts have been opened by direct transfers from the rofit and Loss Account, as would be the case in practice in the majority of ases. From a technical and theoretical point of view, it would be more orrect to open the Ledger accounts by means of a Journal entry.

The dividend accounts and dividend bank accounts would remain open for determined period, according to the practice of the company, probably three onths or six months, and the balances would then be transferred respectively o Dividends Outstanding Account and Unclaimed Dividends Bank Account. here is no legal obligation to open the latter account, but it is convenient: as possible alternative the unclaimed bank balances may be transferred back to e Main Bank Account. Some companies like to keep such balances on a ecial Deposit Account.

The reader will note that the Appropriation Account as set out on p. 494 erely contains the specific ledger entries called for by the question: it is not e complete statutory account which would be circulated to members.

Comparative Profit and Loss Accounts.—The intelligent company ook-keeper will take pride in furnishing his directors with the maxium of useful information. Particularly informative is a tabulated t of accounts showing the figures for two or more years, the increases decreases in the various items, and the percentages of gross and net rofit, and of the principal items of expenditure, to the turnover of the usiness. Too much elaboration will defeat itself, but there can be no uestion that, prepared as suggested, comparative accounts often rove invaluable. Such accounts are, of course, for the director's own se, and not for publication. The precise form in which the accounts e to be published will be determined by the directors.

Necessity for Exactitude.—In some particulars there is even more eed for exactitude in the accounts of limited companies than in those a sole trader. For example, in providing for waste and depreciation, e private trader can adjust the values of his assets at any time by editing the Asset Account and debiting his Capital Account with e amount of the desired provision. A limited company cannot do is. There is the further consideration that the ownership of the ares of a limited company is constantly changing. Hence the rights the shareholders must be equitably adjusted within the confines of ch financial period.

The Balance Sheet.—The construction of Balance Sheets has already een fully discussed in Chapter V, and little is left to mention here. ith the exception of certain Statutory Companies, no company is ound to any particular form of Balance Sheet, so long as the details quired by the Act are properly stated. Perusal of a collection of ublished Balance Sheets will reveal great diversity of form, which ill support the conviction, which by this time the student will doubtss have formed, that there can be no standardisation of company alance Sheets. The majority of companies marshal their assets in e order of their permanence and unrealisability, and range against em, as far as possible, the capital and relevant liabilities. The ternative method of marshalling the assets in the order of their alisability and the liabilities in the order in which they must be met suitable for, and is usually adopted by, banks, discount houses, and milar concerns. Provided that the student is consistent throughout e Balance Sheet, he may adopt either the ascending or the descending ale of realisability, and will be equally correct.

So far as the ordinary manufacturing and trading assets and abilities are concerned, there is little or no difference between the onstruction of the Balance Sheet of a company and that of a private rm engaged in a similar business. What difference there is results om the duty imposed upon a company to protect its capital from iminution, except by the statutory methods already explained. rofits earned, or losses incurred, cannot be added to, or deducted om, the Capital Account as in the case of a private firm. They must e separately stated as the balance of the Profit and Loss Account. his statement is a platitude, and attention is again called to the fact, nly because some candidates, when dealing with company accounts, arry the profit or the loss for the year to the Share Capital Account s though the accounts were those of a private trader. The capital of company as subscribed by its shareholders remains a *permanent* igure until it is increased or reduced by the methods laid down in law.

The following undertakings must present their accounts in the orm prescribed by Statute:—

UNDERTAKING.	SOURCE OF PRESCRIBED FORM.
) Life Assurance Companies	Assurance Companies Act, 1909.
) Building Societies Friendly Societies	As prescribed by the Registrar of Friendly Societies.

Limited companies must present their accounts at least once nnually. Banks issue half-yearly statements (S. 433).

LIMITED COMPANY EXAMINATION QUESTION.

INTERMEDIATE STAGE.

(*Based on a question set by the Royal Society of Arts.*)

Berkshire Contractors, Ltd., has a nominal capital of £100,000, divided into 0,000 shares of £1 each, of which 75,000 shares have been issued and fully called. The Trial Balance of the Company, as on December 31, 19..., was as follows:—

TRIAL BALANCE.

	DR. £	CR. £
Share Capital Account		75,000
Freehold Works, at Cost	25,200	
Machinery and Plant (cost £64,000, depreciation £21,140)	42,860	
Loose Tools, at valuation	1,880	
Contract Executed		76,842
Purchases (Stores and Materials)	24,787	
Workmen's Wages	36,974	
Office Salaries	2,796	
Directors' Fees	750	
Repairs to Machinery and Plant	976	
Rates and Insurance (Works, £2,268; Office, £141)	2,409	
Office Expenses	1,527	
Reserve Account		3,000
Profit and Loss Account Balance (January 1, 19...)		891
Sundry Debtors	17,800	
Sundry Creditors		10,647
Returns	296	1,242
Carriage Inwards	1,576	
Carriage Outwards	941	
Discount Account (Balance)	397	
Cash in hand	1,284	
Bank Overdraft		6,684
General Expenses (Works, £2,976; Office, £201)	3,177	
Interest and Bank Charges	424	
Provision for bad debts (January 1, 19...)		850
Stock (Stores and Materials, January 1, 19...)	7,896	
Office Furniture (cost £900, depreciation £220)	680	
Preliminary Expenses Account (Balance)	526	
	£175,156	£175,156

You are required to prepare Working and Profit and Loss Accounts for the ear ended December 31, 19..., and a Balance Sheet as on that date.

Before preparing these accounts the following matters must be taken into ›nsideration: (*a*) On December 31 the following valuations were made—Stock tores and materials), £3,741; Value of work done on uncompleted contracts on and, £3,000. (*b*) Depreciation is to be provided as follows—Machinery and lant, 10% on cost; Office Furniture, 5% on cost; Loose Tools, 20% on book alue. (*c*) The Provision for Bad Debts is to be further increased by a sum equal › ½% on the Sundry Debtors. (*d*) Provide £250 for fees due to Directors.) Insurance paid in advance amounted to—Works, £226; Office, £15. (*f*) The alance of the Preliminary Expenses Account is to be written off.

For solution *see* pp. 499–501.

LIMITED COMPANY EXAMINATION QUESTION.

ADVANCED STAGE.

(*Based on a question set by the Royal Society of Arts.*)

On January 1, 19..., John Laing, a cigarette manufacturer, converted his usiness into a private limited company under the style of J. Laing & Co., Ltd. he Nominal Capital of the company consisted of 65,000 shares of £1 each; ›,000 of these shares were issued as fully paid to J. Laing and his nominees as ıe purchase price of the business. During the year £5,000 was advanced by . Laing as a loan to the company at 6%, and was secured by the issue of £8,000 % Debentures as collateral.

In addition to the above, the following balances appeared in the company's ooks as on December 31:—

War Loan (3½%), £506; Machinery and Plant, £7,870; Machinery and Plant Additions during the year), £3,680; Purchases, £124,621; Purchases Returns, 2,841; Clearing and Dock Charges, £584; Duty on Tobacco, £212,622; Freight nd Carriage Inwards, £740; Stock (January 1), £48,961; Furniture and Fittings, 1,875; Manufacturing Wages, £14,864; Machinery Repairs, £638; Cash in and, £68; Tobacco Licence, £11; Sales, £410,129; Sales Returns, £4,842; lectric Power, £358; Rent, Rates, and Water (Factory £750, Office £120), £870; ffice Expenses, £224; Advertising, £30,000; Motor Lorries, £1,795; Carriage utwards, £2,048; Management Expenses, Interest, etc., £1,967; Travellers' alaries and Commission, £5,026; Interest on War Loan, £14; Machinery Sold uring the Year, £200; Directors' and Auditors' Fees, £1,200; Office Salaries, 2,142; Discount Account (Debit Balance), £8,764; Removal Expenses, £1,264; ad Debt Provision (January 1), £1,268; Motor Maintenance Expenses, £584; undry Creditors, £17,898; Sundry Debtors, £17,840; Bank Overdraft, £5,682; ills Payable, £3,865; Preliminary Expenses Account, £933.

You are required to prepare Manufacturing and Profit and Loss Accounts ›r the year ended December 31, and a Balance Sheet as on that date.

When preparing these accounts, the following particulars must be taken into onsideration:—

(*a*) Provide for depreciation as follows: Machinery and Plant, 20%; Additions to Machinery and Plant, 10%; Furniture and Fittings, 20%.

(*b*) Carry forward to next year, 20% of Advertising, two-thirds of Preliminary Expenses, and half the Removal Expenses.

(*c*) Provide £2,000 for Bad and Doubtful Debts and 10% on the gross amount of the Sundry Debtors for Discounts.

(*d*) Wages £424, and Office Salaries £78, had accrued due as on December 31. Management Expenses paid in advance amounted to £187.

(*e*) On December 31, Stock was valued at £62,974, and Motor Lorries at £1,120.

(*f*) Provide for a dividend of 10%.

For solution *see* pp. 502–504.

Solution to Intermediate Stage Examination Question.

erkshire Contractors, Ltd.

WORKING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19....

Dr. 19...			£	s.	d.	19...			£	s.	d. Cr.
Jan. 1	To Stock		7,896	0	0	Dec. 31	By Contracts completed . .	£76,842 0 0			
Dec. 31	To Purchases .	£24,787 0 0					*Less* Returns	296 0 0			
	Less Returns	1,242 0 0							76,546	0	0
			23,545	0	0						
" 31	" Wages		36,974	0	0	" 31	" Work done on uncompleted Contracts .	£3,000 0 0			
" 31	" Repairs to Plant . . .		976	0	0	" 31	" Stock . .	3,741 0 0			
" 31	" Rates and Insurance . .		2,042	0	0				6,741	0	0
" 31	" Carriage Inwards . . .		1,576	0	0						
" 31	" General Expenses . . .		2,976	0	0						
" 31	" Balance, being Gross Profit carried to Profit and Loss Account		7,302	0	0						
			£83,287	0	0				£83,287	0	0

Berkshire Contractors, Ltd.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19....

	Dr.		£	s.	d.		Cr.	£	s.	d.
19... Dec. 31	To Salaries		2,796	0	0	19... Dec. 31	By Balance brought down from Working Account	7,302	0	0
" 31	" Rates and Insurance		126	0	0	" 31	" Balance carried down, being Net Loss for year	7,546	0	0
" 31	" Office Expenses		1,527	0	0					
" 31	" Carriage		941	0	0					
" 31	" Discount Account Balance		397	0	0					
" 31	" Interest and Bank Charges		424	0	0					
" 31	" Directors' Fees		1,000	0	0					
" 31	" Depreciation :—									
	Machinery and Plant	£6,400 0 0								
	Office Furniture	45 0 0								
	Loose Tools	376 0 0								
			6,821	0	0					
" 31	" Provision for Bad Debts (Additional)		89	0	0					
" 31	" Preliminary Expenses (Balance)		526	0	0					
" 31	" General Expenses		201	0	0					
			£14,848	0	0			£14,848	0	0
19... Dec. 31	To Balance brought down		7,546	0	0	19... Dec. 31	By Balance brought forward from last year	891	0	0
						" 31	" Balance carried down	6,655	0	0
			£7,546	0	0			£7,546	0	0
19... Dec. 31	To Balance brought down		6,655	0	0					

Berkshire Contractors, Ltd.

BALANCE SHEET, DECEMBER 31, 19....

			£	s.	d.
apital :—					
Nominal : 100,000 Shares of £1 each	£100,000 0 0				
Issued : 75,000 Shares of £1 each, fully paid	75,000 0 0				
evenue Reserve :—					
General Reserve	3,000 0 0				
	78,000 0 0				
Less Profit and Loss Account (Debit Balance)	6,655 0 0		71,345	0	0
irrent Liabilities :—					
Trade Creditors	10,647 0 0				
Expenses accrued (Directors' Fees)	250 0 0				
Bank Overdraft	6,684 0 0		17,581	0	0
			£88,926	0	0

			£	s.	d.
Fixed Assets :—					
Freehold Works, at cost			25,200	0	0
Machinery and Plant, at cost		£64,000 0 0			
Less Depreciation —					
Provided previously	£21,140 0 0				
This year	6,400 0 0				
		27,540 0 0			
			36,460	0	0
Loose Tools, at valuation (see Note (2))			1,504	0	0
Office Furniture —					
At Cost		900 0 0			
Less Depreciation —					
Provided previously	220 0 0				
This year	45 0 0				
		265 0 0			
			635	0	0
			63,799	0	0
Current Assets :—					
Stores and Materials		3,741 0 0			
Work in Progress		3,000 0 0			
Sundry Debtors	17,800 0 0				
Less Provision for Bad Debts	939 0 0				
		16,861 0 0			
Expenses paid in advance (Insurance)		211 0 0			
Cash in hand		1,284 0 0			
			25,127	0	0
			£88,926	0	0

Notes.—(1) The Debit balance on the Profit and Loss Account could be shown as a "fictitious" asset on the right-hand side, but the above treatment is preferred.
(2) The cost of the Loose Tools not being stated, the writing down of last year's figure can only be regarded as a method of valuation, though admittedly a rather de and approximate one.

Solution of Advanced Stage Examination Question.

Messrs. John Laing & Co., Ltd.

MANUFACTURING ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.		£	s.	d.			£	s.	d. Cr.
To Stock		48,961	0	0	By Sales	£410,129 0 0			
,, Purchases	£124,621 0 0				*Less* Returns	4,842 0 0			
Less Returns	2,841 0 0						405,287	0	0
		121,780	0	0	,, Stock		62,974	0	0
,, Clearing and Dock Charges		584	0	0					
,, Duty on Tobacco		212,622	0	0					
,, Freight and Carriage Inwards		740	0	0					
,, Manufacturing Wages		15,288	0	0					
,, Machinery Repairs		638	0	0					
,, Tobacco Licence		11	0	0					
,, Electric Power		358	0	0					
,, Rent, Rates, and Water		750	0	0					
,, Balance carried to Profit and Loss Account		66,529	0	0					
		£468,261	0	0			£468,261	0	0

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.		£	s.	d.		£	s.	d.
To Rent, Rates, and Water					By Balance brought from Manufacturing Account	66,820	0	0
" Office Expenses		120	0	0				
" Advertising		221	10	0				
" Carriage Outwards		21,000	0	0				
" Management Expenses, Interest, etc.		2,098	0	0				
" Travellers' Salaries and Commission		[illegible]	0	0				
" Office Salaries		8,120	0	0				
" Discount		2,220	0	0				
" Removal		8,764	0	0				
" Motor Maintenance Expenses		[illegible]	0	0				
" Preliminary Expenses		551	0	0				
" Provision for Bad Debts, December 31, 19..	£2,500 0 0	111	0	0				
Less Provision, January 1, 19..	1,268 0 0							
" Provision for Discounts		712	0	0				
" Balance carried down		[illegible]	0	0				
		[illegible]	0	0				
		[illegible]	0	0		[illegible]	0	0
" Directors' Fees		[illegible]	0	0	By Balance brought down	[illegible]	0	0
" Auditors' Fees		[illegible]	[illegible]	0	" [illegible] War Loan	[illegible]	0	[illegible]
" Depreciation								
Machinery and Plant	[illegible]							
Furniture and Fittings	[illegible]							
Motor Lorries	[illegible]							
" Loss on Sale of Machinery		[illegible]		[illegible]				
" Balance carried down		[illegible]						
						[illegible]		
[illegible]		[illegible]			By Balance brought down	[illegible]		[illegible]
Balance carried forward								
		[illegible]				[illegible]		

(a) The [illegible]

(b) Depreciation on Machinery and Plant [illegible]

(c) It [illegible] the Management [illegible]

Messrs. John Laing & Co., Ltd.

BALANCE SHEET, DECEMBER 31, 19....

				£	s.	d.
Capital:						
Nominal: 65,000 Shares of £1 each	£65,000	0	0			
Issued: 50,000 Shares, fully paid				50,000	0	0
Revenue Reserve:						
Profit and Loss Account				9,106	0	0
Long Term Liability:—						
Loan (collaterally secured by the issue of £8,000 5% Debentures)				5,000	0	0
Current Liabilities:—						
Trade (assumed) Creditors	17,898	0	0			
Expenses accrued (Wages £424, Salaries £78)	502	0	0			
Bills Payable	3,865	0	0			
Dividend proposed	5,000	0	0			
Bank Overdraft	5,682	0	0			
				32,947	0	0
				£97,053	0	0

				£	s.	d.	£	s.	d.
Fixed Assets:									
Machinery and Plant—									
At cost (see Notes (1) and (2))	£11,275	0	0						
Less Depreciation	1,887	0	0						
				9,388	0	0			
Furniture and Fittings—									
At cost (see Note (1))	1,875	0	0						
Less Depreciation	375	0	0						
				1,500	0	0			
Motor Lorries—									
At current Valuation				1,120	0	0			
							12,008	0	0
Investments, Quoted (see Note (4))—									
£500 3½% War Loan, at cost (Current Market £460)							506	0	0
Current Assets:—									
Stock				62,974	0	0			
Sundry Debtors, *less* provision for Bad Debts and Discounts (see Note (3))				14,056	0	0			
Prepayments (Management Expenses)				187	0	0			
Cash in Hand				68	0	0			
							77,285	0	0
Deferred Revenue Expenditure:—									
Advertising				6,000	0	0			
Removal Expenses				632	0	0			
							6,632	0	0
Fictitious Assets:—									
Preliminary Expenses							622	0	0
							£97,053	0	0

Notes.—(1) The figures shown against Machinery and Furniture represent the actual cost of these assets *to the company*. We are not concerned with past history (before the company's formation).

(2) The information regarding Machinery and Plant is the minimum called for by the Act. Detail regarding additions and sales during the year can, of course be given if desired. For examination purposes a candidate could show such details either in the body of the balance sheet, or separately as "workings."

(3) The amounts of the provisions for bad debts and discounts need not be disclosed, but (as in note (2) above) may be if desired.

(4) Provided that investments are stated under appropriate headings, the names and amounts of holdings need not be disclosed. As regards quoted investments the disclosure of (aggregate) market value (the figure stated here is assumed) is compulsory.

LIMITED COMPANY EXAMINATION QUESTION.

ADVANCED STAGE.

(Based on a question set by the Royal Society of Arts.)

Uprichards, Ltd., a manufacturing company, was registered in 19... with a Nominal Capital of £100,000, divided into 50,000 Ordinary Shares of £1 each and 50,000 7% Cumulative Preference Shares of £1 each.

The company had been formed to purchase an old established business. The net tangible assets taken over from the vendor were valued at £30,000, and the consideration was £40,000, settled by the issue of 20,000 Ordinary shares of £1 each and the payment of £20,000 in cash.

As on June 30, 19..., 20,000 Ordinary Shares and 20,000 Preference Shares had been issued to the public, and fully subscribed. 15*s.* per share had been called and paid up on the Ordinary Shares, with the exception of the last call of 2*s.* 6*d.* per share on 1,000 shares. The Preference Shares had been fully called and paid up.

100 6% Debentures of £100 each had been issued at 96, and were fully subscribed and paid up. The cost of this issue, which was £120, had not been written off.

In addition to the balances represented by the above, the following balances were extracted from the books of the company as on June 30, 19...:—

Machinery and Plant, £12,300 (cost £19,500, depreciation to previous year £7,200); Staff Superannuation Fund, £4,735; Office Salaries, £3,876; Directors' Fees, £2,000; 3½% War Loan (investment of Superannuation Fund), £5,500; Fixtures, Fittings, and Furniture (Office), £500 (cost £700, depreciation to previous year £200); Carriage, Purchases, £378; Carriage, Sales, £416; Factory Power, £568; Lighting and Heating (Factory £126, Office £70), £196; Freehold Factory, £7,892; Freehold Factory, Additions during the year, £1,262; Manufacturing Wages, £29,684; Manufacturing Expenses, £1,929; Stock (at beginning of the year), £42,842; Rates and Insurance (Factory £1,826, Office £110), £1,936; Purchases, £109,861; Sales £156,453; Returns Inwards, £942; Returns Outwards, £1,042; Discount Account (Credit Balance), £428; Bank Loan, £3,000; Cash in hand, £126; Bank Overdraft, £1,824; Creditors, £40,706; Sundry Debtors, £28,960; Office Trade Expenses, £1,294; Repairs to Factory Buildings, £1,372; Transfer Fees, £12; Apprentices' Fees, £500; Bad Debts, £462; Profit and Loss Account (Debit Balance from last year), £8,462; Provision for Bad Debts (at beginning of the year), £800; Bank Interest and Charges, £196; Audit Fee, £250; Bills Payable, £4,784; Motor Lorries, £3,800 (cost £6,400, depreciation to previous year £2,600); Loose Tools, £1,800; Interest on War Loan, £165.

You are required to prepare Manufacturing and Profit and Loss Accounts for the year ended June 30, 19..., and a Balance Sheet as on that date.

When preparing these accounts the following matters must be taken into consideration:—

(*a*) Depreciation is to be provided as follows: Motor Lorries, 15%; Plant and Machinery, 10%; Office Fixtures, Furniture, etc., 5%, all calculated on cost.

(*b*) The unexpired insurance was: Factory £87, and Office £9.

(*c*) The Provision for Bad Debts is to be made up to a sum equivalent to 5% on the Sundry Debtors.

(*d*) An amount of £48 paid to an injured workman, and included in Manufacturing Wages, was recoverable under an Employers' Liability Insurance policy.

(*e*) The following valuations were made as on June 30, 19...: Stock £36,891; Loose Tools, £1,562.

(*f*) The Debenture Interest due, as on June 30, 19..., has not been provided for.

(*g*) The Staff Superannuation fund is to be credited with the company's contribution for the year, £600.

Solution of Advanced Stage Examination Question.

Uprichards, Ltd.

MANUFACTURING ACCOUNT FOR THE YEAR ENDED JUNE 30, 19...

Dr. | Cr.

19...		£	s.	d.	19...		£	s.	d.
Jan. 1	To Stock	42,842	0	0	June 30	By Sales . . £156,453 0 0			
June 30	,, Purchases . £109,861 0 0					*Less* Returns 942 0 0			
	Less Returns 1,042 0 0						155,511	0	0
		108,819	0	0	,, 30	,, Apprentices' Fees	500	0	0
,, 30	,, Carriage (Purchases) . .	378	0	0	,, 30	,, Stock	36,891	0	0
,, 30	,, Factory Power . . .	568	0	0					
,, 30	,, Lighting and Heating . .	126	0	0					
,, 30	,, Manufacturing Wages . .	29,636	0	0					
,, 30	,, Manufacturing Expenses .	1,929	0	0					
,, 30	,, Rates and Insurance . .	1,739	0	0					
,, 30	,, Repairs to Factory . .	1,372	0	0					
,, 30	,, Balance carried to Profit and Loss Account . . .	5,493	0	0					
		£192,902	0	0			£192,902	0	0

Uprichards, Ltd.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED, JUNE 30, 19....

Dr.			£	s.	d.			£	s.	d. Cr.
19...						19...				
June 30	To Office Salaries		3,876	0	0	June 30	By Balance brought from Manufacturing Account	5,493	0	0
" 30	" Carriage (Sales)		416	0	0	" 30	" Discount Account (Balance)	428	0	0
" 30	" Lighting and Heating		70	0	0	" 30	" Transfer Fees	12	0	0
" 30	" Rates and Insurance		101	0	0	" 30	" Balance carried down	1,730	0	0
" 30	" Office Expenses		1,294	0	0					
" 30	" Bad Debts		462	0	0					
" 30	" Provision for Bad Debts:—									
	June 30, 19...	£1,448 0 0								
	Less July 1, 19...	800 0 0	648	0	0					
" 30	" Contribution to Superannuation Fund		600	0	0					
" 30	" Interest and Bank Charges		196	0	0					
			£7,663	0	0			£7,663	0	0
19...						19...				
une 30	To Balance brought down		1,730	0	0	June 30	By Balance carried down	7,763	0	0
" 30	" Directors' Fees		2,000	0	0		*Note.*—No depreciation has been provided in respect of the Factory Buildings (see note).			
" 30	" Audit Fee		250	0	0					
" 30	" Interest on Debentures		600	0	0					
" 30	" Depreciation:—									
	Machinery and Plant	£1,950 0 0								
	Fixtures and Fittings	35 0 0								
	Motor Lorries	960 0 0								
	Loose Tools	238 0 0	3,183	0	0					
			£7,763	0	0			£7,763	0	0
19..						19..				
ne 30	To Balance from last year		8,462	0	0	June 30	By Debit Balance carried forward	16,225	0	0
" 30	" Balance brought down		7,763	0	0					
			£16,225	0	0			£16,225	0	0

Note.—This "note" is obligatory (8th Schedule para. 14 (2)).

Uprichards, Ltd.

BALANCE SHEET, JUNE 30, 19...

				£	s.	d.
Capital:—						
Nominal—						
50,000 Ordinary Shares of £1 each . .	£50,000	0	0			
50,000 7% Preference Shares of £1 each .	50,000	0	0			
	£100,000	0	0			
Issued—						
Ordinary Shares—						
20,000 Shares of £1 each (issued as fully paid to Vendor)	20,000	0	0			
20,000 Shares of £1 each (issued to Public), 15s. called	15,000	0	0			
	35,000	0	0			
Less Unpaid Calls	125	0	0			
	34,875	0	0			
20,000 7% Preference Shares of £1 each .	20,000	0	0			
	54,875	0	0			
Less, Profit and Loss Account, Debit balance	16,225	0	0	38,650	0	0
Fixed Liabilities:—						
6% Debentures (secured (assumed))				10,000	0	0
Staff Superannuation Fund (see Note (1))				5,500	0	0
Current Liabilities:—						
Trade Creditors	£40,706	0	0			
Debentures Interest accrued	600	0	0			
Bills Payable	4,784	0	0			
Bank Loan (see Note (2))	3,000	0	0			
Bank Overdraft	1,824	0	0	50,914	0	0
				£105,064	0	0

				£	s.	d.	£	s.	d.
Goodwill, at cost (Note (3))							10,000	0	0
Fixed Assets:—									
Freehold Works, at cost				9,154	0	0			
Machinery and Plant—									
At cost	£19,500	0	0						
Less Depreciation .	9,150	0	0						
				10,350	0	0			
Fixtures and Furniture—									
At cost	700	0	0						
Less Depreciation .	235	0	0						
				465	0	0			
Motor Lorries:—									
At cost	6,400	0	0						
Less Depreciation .	3,560	0	0						
				2,840	0	0			
Loose Tools: at valuation				1,562	0	0			
							24,371	0	0
Investments in Government Securities (representing Staff Superannuation Fund), at cost (Current Market Value, £5600 (assumed))							5,500	0	0
Current Assets:—									
Stocks				36,891	0	0			
Sundry Debtors, *less* provision for bad debts				27,560	0	0			
Prepayment (unexpired insurance) . .				96	0	0			
Cash in hand				126	0	0			
							64,673	0	0
Fictitious Assets (see Note (4)):—									
Discount on Debentures				400	0	0			
Expenses of issuing Debentures . . .				120	0	0			
							520	0	0
							£105,064	0	0

Notes.—(1) Staff Superannuation Fund, per list of balances, £4,735; add War Loan Interest, £165, Company's contribution, £600.

(2) It is assumed that the bank loan is only temporary, if it were not repayable for (say) more than a year ahead it should appear under Fixed Liabilities.

(3) The difference between the consideration for the business taken over £40,000, and the net assets acquired, £30,000 is taken to represent the price paid for goodwill.

(4) These two items *must* be stated separately (Eighth Schedule, para. 3 (*b*) and (*d*)).

EXAMINATION QUESTIONS.

1. The directors of a limited company forfeited 1,000 Ordinary Shares of £1 each owing to non-payment of the final call of 10*s.* per share. The shares were subsequently re-issued to another shareholder for a cash payment of 22*s.* 6*d.* per share.

(1) Are these proceedings *intra vires*?

(2) What steps should you take to enable you to arrive at a decision?

(3) How should the transactions be dealt with in the Balance Sheet which you are asked to certify? (*Chartered Accountants.*)

2. You are instructed by the directors of a limited company to examine and initial as correct all new share certificates before they are submitted to them for signature and sealing.

State in detail how you would proceed, and what books and documents you would examine. (*Chartered Accountants.*)

3. Compare and contrast the Balance Sheets necessary in: (*a*) Private Partnership; (*b*) Private Limited Company; (*c*) Public Limited Company. (*Royal Society Arts.*)

4. When auditing the accounts of Hugh Dickson, Ltd., you find the following Journal entry:—

		£	£
Sundry Shareholders	Dr.	100	
To Interest Account			100

For interest at 6% on calls in arrear.

Do you approve of this entry? If so, under what conditions? (*Chartered Accountants.*)

5. A limited company, registered on March 31, takes over the assets and liabilities of a trading concern as on January 1. The profits for the six months to June 30 were £5,000. How would you deal with this sum on closing the books on June 30? Is the profit available for distribution? (*Chartered Accountants.*)

6. A limited company was incorporated on April 15, 19..., to take over the business of a vendor firm as from December 31 previous. The Agreement for Sale was entered into by the vendors with a trustee for the intended company on March 31, and was expressly referred to, and its adoption by the company provided for, in the Articles of Association. It contained provisions that all the profits of the business as from December 31, 19..., should belong to the company, and that the vendors should continue trading in the usual way for the benefit of the company until completion, and be indemnified and account accordingly. The agreement was adopted on April 30, and completion took place on May 31, 19.... The accounts for the year show a net profit for the whole year of £12,000, and the Directors proposed to divide the whole as dividend. What considerations govern the determination of the amount distributable? (*Chartered Accountants.*)

7. A limited company is formed to buy a property from B for £50,000; £25,000 in cash and £25,000 in shares. The Capital is £75,000 in 75,000 shares of £1 each. 55,000 shares are issued, 5*s.* payable on application, 5*s.* on allotment, 5*s.* on first call, and 5*s.* on final call.

The purchase money, £25,000, is paid, and the consideration shares are allotted to B.

The preliminary expenses, £2,200, are paid by the company. Shareholders holding 820 shares fail to pay the final call, and the shares are forfeited under the Articles of Association.

State the Cash Book, Journal, and Ledger entries necessary to record the facts. (*Incorporated Accountants.*)

8. Chatenays, Ltd., have accumulated a Reserve Account of £50,000. The Nominal Capital of the Company consists of 300,000 shares of £1 each, of which 200,000 shares have been issued and fully paid up. The directors propose to distribute the Reserve Account by the issue of one fully paid share for every four shares held. What is your opinion of this proposal? Give the entries necessary in order to record the new issue of shares in the Company's books and Balance Sheet. (*Royal Society Arts.*)

9. The Exotic Mining Company, Ltd., with an Authorised Capital of £50,00 undertook on June 1, 19..., to buy the "Exotic" and "Eldorado" gold-minin claims from the General Agency Company, Ltd., for £10,000, payable as £1,000 in cash, as to £4,000 in fully paid Ordinary Shares, taken at par, and as £5,000 in 6% First Mortgage Debentures.

On June 7, 19..., the Company offered for subscription 40,000 £1 Ordinar Shares at a premium of 2s. per share, payable 5s. per share (including 2s. premiu on application, 5s. per share on allotment, and the balance of 12s. per share July 15, 19....

Applications were received for 35,950 shares, all of which were allotted June 10, 19.... All allotment moneys were duly paid on June 14, 19....

The purchase agreement was carried out on June 10, 19..., the requisit allotments of shares and debentures and the payment of cash then being made.

All shareholders, except one holding 100 shares, duly paid the calls due July 15.

The shares belonging to the defaulting member were declared to be forfeite by the Board on July 31, and were re-issued by the Board on August 7 to t chairman (the Hon. Hugo Porter, M.P.), on his paying in cash the 12s. per sha left unpaid by the original allottee.

Pass these transactions through the Company's books of account, and prepa a Balance Sheet at their conclusion. (*London Chamber Commerce.*)

10. The following are Balance Sheets of two Companies, A and B, on June 3 19...:—

COMPANY A.

	£	£
Share Capital, fully paid	149,500	
Forfeited Shares Accounts	125	
Debentures	40,000	
Plant and Machinery		37,500
Freehold Property		43,000
Bank Account		2,000
Goodwill		40,000
Sundry Creditors	5,875	
Sundry Debtors		25,000
Stock		68,000
Profit and Loss Account	20,000	
	£215,500	£215,500

COMPANY B.

	£	£
Share Capital	40,000	
Debentures	3,000	
Calls in arrear		500
Plant and Machinery		2,500
Freehold Property		2,000
Debtors and Creditors	25,000	22,500
Stock		18,000
Profit and Loss Account		16,500
Goodwill		6,000
	£68,000	£68,000

Company A decides to take over Company B, and agrees to discharge t liabilities and debentures and take over all the assets, the consideration bein £1,200 cash and £30,000 shares in Company A, issued as fully paid up. T calls in arrear are worthless, and the shares were forfeited by the Directors Company A prior to amalgamation. Company B is to pay its own costs liquidation.

Draw up a Balance Sheet of the new Company as the result of the incorpor tion. (*Incorporated Accountants.*)

11. The Rex Company, Ltd., agreed to purchase from Alfred Pratt the assets and goodwill of his business, which were as follows: Freeholds, £3,000; Plant, £8,000; Goodwill, £7,000; Stock, £2,000 = Total Assets of £20,000. Payment was made on November 1, 19..., as to £15,000 in 5% Debentures, and the balance in Ordinary Shares of £1 each, valued at a premium of 5*s.* each. Show the necessary entries in the books of the Company to record the transactions.

12. A limited company is formed to purchase an existing business with a nominal capital of £200,000, one-half in Ordinary and one-half in 5% Preference Shares of £1 each. 60,000 of the Ordinary Shares are issued at a premium of 5*s.* per share, the Preference Shares being all issued at par; 5*s.* per share being payable on application and 10*s.* on allotment in each case. £20,000 6% Debentures are underwritten at 98%. On account of the purchase money of £54,000 a sum of £8,000 is paid in discharge of the liabilities of the vendor, and the following assets taken over: Stock-in-trade, £12,000; Book Debts, £20,000; Machinery and Plant, £6,000.

Journalise the entries necessary for recording the purchase in the books of the company. (*Incorporated Accountants.*)

13. On January 1, 19..., a company, with a Nominal Capital of £20,000, divided into 10,000 Ordinary Shares of £1 each, and 1,000 6% Preference Shares of £10 each, was formed to acquire the business of Albert Durand. It was agreed to allot as fully paid to the vendor, as purchase consideration of the assets acquired, 5,000 Ordinary Shares and 500 Preference Shares. On January 5, 19..., the balance of the Ordinary Shares was issued to the public at a premium of 5*s.* per share, and 75% of this issue was duly applied for, the terms of subscription being 10*s.* per share (including the premium) on application, 7*s.* 6*d.* per share on allotment, and the balance on March 31, 19....

The company carried out its agreement with Albert Durand, and went to allotment on January 12. All cash due on application and allotment was paid with the exception of that due on allotment of 500 shares to Victor Verdier. These shares were forfeited by resolution of the directors on March 15, 19..., and were re-issued on March 22, 19..., to Hugh Dickson on payment of the amount due on the shares.

You are required to show how these transactions would appear in the books of the company, assuming that the call due on March 31, 19..., has been made, but that no cash has been received in respect of it. (*London Chamber Commerce.*)

14. Simcox and Westby's Balance Sheet at December 31, 19.1, showed the following figures: Land and Works, £120,000; Stocks and Work in progress, £70,000; Patents, Licences, etc., £10,000; Book Debts, £60,000; Cash at Bankers and in hand, £40,000; Bills Receivable, £10,000; Trade and Cash Creditors, £100,000.

They sold the business to a company (which was formed with a Share Capital of £200,000, divided into 100,000 Ordinary and 100,000 Preference Shares of £1 each, and a Mortgage Debenture Capital of £100,000) for £300,000, to be satisfied by the issue to them of the whole of the Ordinary Shares, 50,000 of the Preference Shares, £50,000 Debentures, and the balance in cash.

The balance of the Preference Shares (at par) and of the Debentures (at 105) were issued to and taken up and paid for by the public as follows:—

	Preference Shares.	Debentures.
On application	2*s.*	25%
On allotment	8*s.*	40%
On March 31, 19.2	10*s.*	40%

Underwriting and preliminary expenses amounted to £16,000.

Make the necessary entries in the company's books, and prepare the opening Balance Sheet. (*Chartered Accountants.*)

15. Make the necessary Journal entries to record the following transactions of limited company:—

(1) *January* 1, 19...—The company purchased from vendors Plant and Machinery valued at £5,000, Stock-in-trade valued at £2,500, and Patent Rights alued at £3,000.

(2) *January* 10, 19...—The company allotted to vendors, in part payment purchase of these assets, 800 fully paid Ordinary Shares of £10 each, and issu 25 Mortgage Debentures of £100 each in satisfaction of the balance of purcha money.

(3) *January* 15, 19...—The company allotted to applicants 1,000 Ordina Shares of £10 each, having received on same date £2 per share, the amou payable on application and allotment.

(4) *February* 15, 19...—First call of £2 per share made on 1,000 Ordina Shares.

(5) *February* 20, 19...—Payment of first call received in full.

(6) *March* 1, 19...—The company received £2,500 in respect of Book Deb due to vendors, agreed to be collected on their behalf. Vendors agreed accept 30 Mortgage Debentures of £100 each in payment thereof, and the Debentures were issued to them on this date.

(7) *April* 1, 19...—Certain shareholders being desirous of paying up t balance due on their shares pending further calls, the company agreed to all them 5% per annum interest on the calls paid in advance. £3,000 was receiv on this date from shareholders under this arrangement.

(8) *April* 15, 19...—The company applied the sum of £2,300 in redeemi 20 Debentures of £100 each at a premium of 10% with £100 interest thereon date of redemption.

In addition to the entries in the Books of Account, state briefly what oth entries must be made in the records of the company in respect of the abo transactions. (*Chartered Accountants.*)

16. The Esk Vale Lumber Company, Ltd., agreed to purchase the busine of O. Henry, timber merchant, as on January 1, 19.... O. Henry's Balan Sheet on that date was as follows:—

LIABILITIES.	£	ASSETS.	£
Sundry Creditors	2,500	Land and Buildings (subject to Mortgage *contra*)	30,0
Bills Payable	6,000	Fixed Plant and Machinery	10,0
Loan on Mortgage of Land and Buildings *contra*	10,000	Loose Plant and Tools	3,0
Bank Overdraft	15,000	Stock-in-trade	12,0
O. Henry's Capital	32,500	Sundry Debtors	10,5
		Cash in hand	5
	£66,000		£66,0

The purchase price was fixed at £55,000; and, in addition, the Esk Va Company, Ltd., took over the mortgage, and agreed to discharge the liabilit to Sundry Creditors and upon Bills Payable. The purchase price was to discharged by the payment of £20,000 in cash and the allotment of £20,0 Ordinary Shares, fully paid, and £15,000 6% Cumulative Preference Shar fully paid.

The purchase was completed by the payment of the cash and the allotment the shares on February 2, 19....

Make the necessary Journal entries (in the books of the Esk Vale Lumb Company, Ltd.) for recording the above transactions. (*Chartered Accountants*

17. The Wire Rope Company, Ltd., was formed to acquire the business Galt & Co., whose Balance Sheet at the date of purchase was agreed as follows:

LIABILITIES.	£	ASSETS.	£
Creditors	2,500	Cash in hand	1
Capital	13,000	Cash at Bank	8
		Debtors	3,1
		Stock-in-trade	5,0
		Fixtures, etc.	5
		Machinery	3,9
		Leasehold Premises	2,0
	£15,500		£15,5

The agreement entered into provided that the purchase price should be £18,000, payable as to £12,000 in cash, and as to £6,000 by the allotment of 6,000 fully paid shares of £1 each in the Company. The Nominal Capital of the Company was £30,000, of which 20,000 shares of £1 each were allotted on July 1, 19..., payable as to 10*s*. on application and 10*s*. on allotment. The whole of the cash due in respect of the shares was duly received. The cash consideration was paid by the Company on July 20, and the vendor's shares were allotted on that date. The preliminary expenses amounted to £400.

Open the books of the Company, recording the above transactions, and prepare a Balance Sheet as at July 20. (*Incorporated Accountants.*)

18. The Atalanta Insurance Company (having on June 30, 19..., a called-up Capital of £250,000 in £10 shares, £1 paid, quoted on the market at £22 10*s*., and a Reserve Fund of £1,500,000) purchases, on November 30, 19..., the business of the X.Y.Z. Insurance Company (having on June 30, 19..., a called-up Capital of £200,000 in £20 shares, £2 paid, quoted on the market at £8 10*s*., and a Reserve Fund of £600,000) for £45 for each five shares, giving one-half of the consideration in its shares taken at the value of £22 10*s*. each, and one-half in 4% Debenture Stock taken at par. In addition, 7*s*. a share in cash is to be given by way of dividend to December 31, 19....

Show how the accounts of the Atalanta Company will stand after the purchase has been completed. (*Chartered Accountants.*)

19. The A Company, Ltd., in 19..., sold one department of its business to the B Company, Ltd. The value of this branch, according to the books of the Company, was £20,000. The purchase price was fixed at £30,000, to be discharged by the issue to the A Company, Ltd., of 30,000 Ordinary Shares of £1 each, fully paid, in the B Company, Ltd.

The A Company, Ltd., had borrowed from S. Antony £20,000 at 6%, and the B Company, Ltd., being very prosperous, Antony, in 19..., agreed to accept 10,000 B Company shares at £2 per share in discharge of the loan. These shares were accordingly transferred to Antony on June 30, 19....

Draft the Journal entries necessary to record the above transactions in the books of the A Company, Ltd. How would you deal with the apparent profit on the sale to the B Company, Ltd., and on the transfer of the B shares to Antony? (*Chartered Accountants.*)

20. The Simplex Engineering Company, Ltd., purchased certain patents from C. Bantock, under an agreement dated June 30, 19..., at a cost of £40,000. £1,000 of this sum was to be paid to the vendors in cash, and the balance in fully paid £10 Ordinary Shares.

Including the shares allotted as fully paid to the vendors, the Company issued Capital to the extent of £75,000, consisting of £50,000 in Ordinary Shares of £10 each (£1 on application, £4 on allotment, and £5 at the end of three months), and £25,000 in 5% Preference Shares of £5 each (£1 on application, £2 on allotment, and £2 at the end of three months).

Under the agreement with Bantock, the patents passed to the Company on July 9, 19..., which date was also the date of allotment.

All the shares issued to the public were fully subscribed and duly paid for with the exception of £200 calls in arrear on the Preference Shares. All cash was paid direct to the Company's Bankers.

Make the necessary entries in the books of the company to give effect to the above transactions, and show how they would appear in the Company's first Balance Sheet. (*London Chamber Commerce.*)

21. On December 31, 19..., the Spen Main Colliery Company, Ltd., had Ordinary Share Capital, authorised and fully subscribed, of £200,000, in shares of £10 each, and a General Reserve of £150,000. During 19... the Capital was ncreased by £100,000, in new shares of £1 each; and the original shares were onverted into shares of £1 each. Resolutions were duly passed, whereby 100,000 of the Reserve was distributed to the ordinary shareholders as bonus, nd was applied in satisfaction of new shares issued to the shareholders at par. et out the Journal entries and the accounts in full recording the foregoing transactions, and the information, in respect thereof, which should appear on t Balance Sheet of the Company as on December 31, 19.... *(Chartered Accountant*

22. The following particulars have been extracted from the Balance Sheet Soleil d'Or, Ltd., as on December 31, 19... :—

CAPITAL.

	£	£
Nominal: 10,000 5% Preference Shares of £5 each .	50,000	
100,000 Ordinary Shares of £1 each	100,000	
	£150,000	
Issued: 5,000 5% Preference Shares of £5 each .	25,000	
50,000 Ordinary Shares of £1 each	50,000	
		75,000
Reserve Fund		20,000
Profit and Loss Account (Balance)		12,000

During the year 19... resolutions were duly passed as follows:—

(1) A resolution converting the Preference Shares into Preference Shares £1 each.

(2) A resolution declaring a bonus of 20% on the Ordinary Shares, to provided as to £6,000 out of the Reserve Fund, and as to the remainder c of the balance of Profit and Loss Account. The bonus to be satisfied by t issue of one fully paid Ordinary Share for every five Ordinary Shares held.

Give the Journal entries which are necessary to carry out the above reso tions, and show how they would affect the Balance Sheet of the Company as December 31, 19.... Assume that the profit for the year 19... amounted £4,000. *(London Chamber Commerce.)*

23. On December 31, 19..., the Balance Sheet of Ravary's, Ltd., was follows:—

LIABILITIES.	£	ASSETS.	£
Nominal Capital, £20,000, divided into 10,000 6% Cumulative Preference Shares of £1 each, and 10,000 Ordinary Shares of £1 each.		Land and Buildings . .	2,
		Plant and Machinery . .	5,
		Tools and Utensils . .	1,
		Stock	7,
		Sundry Debtors . . .	3,
		Bills Receivable . . .	
Paid-up Capital:—		Cash	
6,000 Ordinary Shares .	6,000	Profit and Loss Account:—	
6,000 Preference Shares .	6,000	Dr. Balance . . .	8,
	12,000		
5% Debentures . .	3,000		
Sundry Creditors . .	5,000		
Bills Payable . .	3,000		
Bank Overdraft . .	4,000		
	£27,000		£27,

It was decided to reconstruct the Company, and for this purpose Rava (19...), Ltd., was registered with a Capital of £20,000, divided into 8,000 Ordin Shares of £1 each, and 12,000 7% Preference Shares of £1 each, to take over assets and liabilities of the old company.

The Debenture holders of Ravary's, Ltd., agreed to accept 7% Cumula Preference Shares in Ravary's (19...), Ltd., in exchange for their Debentures.

The Preference shareholders in Ravary's, Ltd., were to receive one Preference Share in Ravary's (19...), Ltd., for every three shares held by them in the old company.

The Ordinary shareholders were to be allotted one Ordinary Share, 15*s*. paid, in Ravary's (19...), Ltd., in exchange for every four shares held by them in the old company.

The costs of the liquidation of Ravary's, Ltd., were paid by the new company.

Give the Journal entries necessary to record the above transactions in the books of Ravary's, Ltd. (*Chartered Accountants.*)

24. Two companies, O and P, amalgamate and form a new company.

The position of the two companies was as follows:—

O COMPANY.

	£		£
Capital paid up	30,000	Debtors	18,000
Debentures	5,000	Stock	20,000
Creditors	5,000	Goodwill	5,000
Profit and Loss Account	3,000		
	£43,000		£43,000

P COMPANY.

	£		£
Capital paid up	20,000	Debtors	20,000
Creditors	8,000	Stock	10,000
Profit and Loss Account	2,000		
	£30,000		£30,000

The average profits of the O and P Companies have been £3,000 and £2,000 respectively. The new Q Company agrees with the O and P Companies to take over both concerns for the sum of £60,000, and, in addition, to discharge all iabilities; £10,000 to be paid in cash, and the balance in shares.

The profit on the conversion is to be divided between the shareholders of the O and P Companies in the same proportion as the profits previously earned by the Companies.

Draw up a Purchase Account on the completion of the Q Company, and show how the Share Capital Accounts in the O and P Companies should be closed.

C. Cox held 5,000 £1 shares in O Company and 4,000 £1 shares in P Company. Show how much cash and how many shares Cox should receive from the new Company. (*Incorporated Accountants.*)

25. X, Y, and Z, each with a separate business, agree to amalgamate and carry on as a private limited-liability company with a nominal Capital of £40,000; each taking, as payment for his Capital, fully paid-up shares in the company, and the assets and liabilities being taken over as they stand in the books of the everal businesses.

X's assets and liabilities were: Stock, £3,000; Book Debts, £5,350; Bills Receivable, £1,582; Balance at Bank, £895; Sundry Creditors, £3,000; Bills Payable, £2,000.

Y's assets and liabilities were: Stock, £4,290; Book Debts, £9,250; Bills Receivable, £1,580; Balance at Bank, £1,290; Sundry Creditors, £8,395.

Z's assets and liabilities were: Stock, £8,000; Book Debts, £18,950; Bills Receivable, £3,860; Balance at Bank, £2,350; Sundry Creditors, £15,382; Bills Payable, £5,852; Reserve Fund, £5,000.

Prepare the initial Balance Sheet of the Company. The preliminary expense of formation, amounting to £250, were paid. (*Chartered Accountants.*)

26. When auditing the books of a limited company, you find the under stated Journal entry:—

	£	£
Loan Account, Dr.	10,000	
To London and Loamshire Bank . . .		10,000
For loan secured by the issue of £12,000 of the 5% Debentures of the company.		

Explain the meaning of this entry, and state how the transaction shoul appear in the published Balance Sheet of the company. (*Chartered Accountants.*

27. The following are the Balance Sheets on December 31, 19..., of the Fa and Nefas Companies respectively:—

FAS COMPANY, LTD.

LIABILITIES.	£	ASSETS.	£
Capital, 100,000 shares, £1		Freehold Premises . .	22,50
each, fully paid . .	100,000	Machinery and Plant . .	32,65
Sundry Creditors . .	18,129	Sundry Debtors . .	24,68
Reserve	7,000	Stock	38,64
Profit and Loss, balance .	16,440	Cash in Bank and in hand .	23,08
	£141,569		£141,56

NEFAS COMPANY, LTD.

LIABILITIES.	£	ASSETS.	£
Capital, 6,000 shares, £5		Machinery and Plant, cost .	22,24
each, fully paid . .	30,000	Sundry Debtors . .	6,24
Sundry Creditors . .	10,270	Stock	9,42
		Cash	12
		Profit and Loss, balance .	2,22
	£40,270		£40,27

It is agreed that the Fas Company shall purchase the Nefas Company as o December 31, 19..., on the following basis:—

(1) A dividend of 15% to the shareholders of the Fas Company, to b declared prior to the amalgamation.

(2) The Fas Company to take over the assets of the Nefas Company, th consideration being: (*a*) The payment of the liabilities of the Nefas Company (*b*) the payment of the costs of amalgamation; (*c*) the issue to the shareholder of the Nefas Company of seven fully paid shares of £1 each in the Fas Compan for every two fully paid shares in the Nefas Company.

The costs of amalgamation amounted to £1,206. The floating assets of th Nefas Company were worth the values stated on the Balance Sheet. Draft th Journal entries recording the purchase in the books of the Fas Company, an set out the Balance Sheet of the Company after the amalgamation. (*Charter Accountants.*)

28. Two companies carrying on similar businesses decide to amalgamate a on and from January 1, 19....

Their respective agreed Balance Sheets at December 31 previous were a follows :—

X Company, Ltd.

Liabilities.	£	Assets.	£
7,500 Ordinary Shares, £10 each	75,000	Freehold Land and Buildings	12,000
Sundry Creditors	4,000	Plant and Machinery (less depreciation)	19,500
Reserve Fund	5,000	Stock	15,000
Profit and Loss Account	2,000	Sundry Debtors	8,000
		Cash in hand and at Bank	1,500
		Goodwill	30,000
	£86,000		£86,000

Y Company, Ltd.

Liabilities.	£	Assets.	£
5,000 Ordinary Shares of £10 each	50,000	Plant and Machinery	25,000
Sundry Creditors	3,500	Stock	12,000
Depreciation Fund	2,500	Sundry Debtors	6,000
Profit and Loss Account	2,500	Cash in hand and at Bankers	500
		Goodwill	15,000
	£58,500		£58,500

X Company, Ltd., which has been in existence for several years, has regularly depreciated plant and machinery, but Y Company, Ltd., only commenced business on January 1, 19..., and plant and machinery stands at cost, depreciation having been provided for by means of a Depreciation Fund.

It is agreed that the combined Company shall take over the assets (including goodwill) and discharge the liabilities of each Company on the basis of the figures in their respective Balance Sheets.

The Capital of the combined Company was £200,000, divided into 100,000 Ordinary Shares of £1 each, and 100,000 6% Cumulative Preference Shares of £1 each.

The combined Company issued £15,000 Ordinary Shares at par for cash, and agreed to allot to each shareholder in the X and Y Companies five Ordinary and ive Preference Shares of £1 each, fully paid, in exchange for each £10 share held by them, and to discharge any balance in cash.

Draw up the Balance Sheet of the combined Company, after the above transactions have been completed, and show what each shareholder in the Z and Y Companies would receive in shares in the new Company and in cash. (*Chartered Accountants.*)

29. Two private companies, the A Company, Ltd., and B Company, Ltd., amalgamate in the following manner:—

A holding company, called the C Company, Ltd., was registered on July 1, 9..., with a Capital of £200,000 in £1 shares, to purchase all the Ordinary Shares of both Companies. X, the Managing Director of the A Company, Ltd., and Y, he Managing Director of the B Company, Ltd., each took up and paid for 1,000 hares.

The Issued Capital of the A Company, Ltd., consisted of 75,000 Ordinary hares of £1 each, fully paid, and 60,000 6% Cumulative Preference Shares of £1 ach, fully paid. The Issued Capital of the B Company, Ltd., consisted of 40,000 rdinary Shares of £1 each, fully paid.

The A Company, Ltd., shareholders received one £1 share fully paid in the Company, Ltd., in exchange for each of their Ordinary Shares. The B Company, td., shareholders received one and a half £1 shares, fully paid, in the C Company, td., in exchange for each of their Ordinary Shares.

The formation and preliminary expenses of the C Company, Ltd., amounting £1,500, were paid out of cash.

Make the necessary entries in the books of the three companies to give effec to the above arrangements, and set out the opening Balance Sheet of the Company, Ltd. (*Chartered Accountants.*)

30. The X Company agreed to take over the Y Company as a going concern The X Company was to pay the debentures and liabilities of the Y Company and take over the assets, the consideration being the issue by the X Company c 40,000 fully paid shares of £1 each, and the payment of £3,000 in cash to the Company. The X Company was to pay the liquidation expenses, which amounte to £1,400.

The balances in the books of the respective Companies as on the date c absorption, are as follows:—

	X Dr.	Y Dr.	X Cr.	Y Cr.
	£	£	£	£
Nominal Share Capital:—				
X Company, 200,000 shares of £1 each.				
Y Company, 75,000 shares of £1 each.				
Capital issued	—	—	150,000	50,000
Unpaid Calls	500	100	—	—
5% Debentures	—	—	50,000	10,000
Freehold and Leasehold Property	103,330	35,682	—	—
Goodwill	30,000	5,000	—	—
Sundry Creditors	—	—	8,342	4,362
Sundry Debtors	7,240	3,984	—	—
Bank Balances	16,842	—	—	2,000
Stock	17,926	7,852	—	—
Plant and Machinery	38,768	16,439	—	—
Bills Receivable	3,621	—	—	—
Profit and Loss Account Balance	—	—	9,885	2,695
	£218,227	£69,057	£218,227	£69,057

Assume that the absorption was duly effected, but that the unpaid calls an a book debt of £400 due to the Y Company proved irrecoverable.

Prepare the Balance Sheet of the X Company after absorption of the Company. (*Chartered Accountants.*)

31. The accounts of the Clifford Trading Co., Ltd., for the financial yea ended April 30, 19..., show a net profit of £125,000. The Company has a issued and paid-up capital of £600,000 divided into 400,000 Ordinary Share of £1 each and 200,000 6% Preference Shares of £1 each. There was a credi balance of £24,891 13s. 4d. brought forward as Profit and Loss Account from th previous period. The directors decide at March 31, 19..., subject to the approva of the members in General Meeting, to apportion the available profit as follows (1) Pay the year's dividend on Preference Shares. (2) Write £10,000 off Goodwil (3) Carry £20,000 to General Reserve Account. (4) Redeem 25 Debentures a £1,000 each at par. (5) Pay a dividend on the Ordinary Shares free of Incom Tax up to such an amount as will leave a balance of not less than £20,000 to b carried forward.

Show the effect of this decision of the directors in the form of an Appropriatio Account, making a reserve for Income Tax at 4s. in the £. It may be assume that all items in the Profit and Loss Account have been allowed for Income Ta purposes.

32. The Profit and Loss Account of Soleil d'Or, Ltd., prior to the paymen of debenture interest for the half-year to December 31, 19..., disclosed a profit c [illegible] as on December 31, 19.... The Paid-up Capital of the Company consiste

of £100,000, divided into 50,000 5% Preference Shares of £1 each, and 50,000 Ordinary Shares of £1 each. 100 Debentures of £100 each at 4% had also been issued. The directors made the under-mentioned recommendations for the disposal of the above balance which were approved by the shareholders at the annual meeting: (1) To pay the half-year's interest to December 31, 19... due on the Debentures. (2) To pay the Preference dividend for the half-year to December 31, 19.... (3) To pay a dividend for the year ended December 31, 19..., of 10% on the Ordinary Shares, free of Income Tax. (4) To transfer £5,000 to Reserve, raising that Account to £15,000 in all. (5) To carry forward the balance to next year. Show the entries necessary to record these transactions in the books of Soleil d'Or, Ltd. (*London Chamber Commerce.*)

33. The Profit and Loss Account of a limited company showed a credit balance of £53,368 10*s.* 8*d.*

The directors of the company decided to dispose of this balance as follows: (1) To transfer £500 to a Forged Transfers Reserve Account and £8,000 to General Reserve Account; raising the latter to £20,000. (2) To pay the half-year's dividend due on the £150,000 6% Preference Shares. (3) To pay a dividend of 8% on the £250,000 Ordinary Shares free of tax. (4) To write off the balance of the Debenture Issue Expenses Account which stood at £3,876. (5) To carry forward the balance to next year.

Assume that these proposals were confirmed by the shareholders, and give the entries necessary to record them in the books of the company. Assume that Income Tax was 9*s.* 6*d.* in the £.

34. The Newspaper Trust, Ltd., was registered (Nominal Capital £110,000—50,000 7% £1 Preference Shares, 50,000 £1 Ordinary Shares, and 10,000 £1 Deferred Shares), to purchase an established county newspaper. All the Preference Shares were issued fully called and paid up. All the Ordinary Shares were offered, and 45,000 applied for and allotted, 15*s.* per share was called and paid up, except a call of 5*s.* per share on 1,000 shares. 2,000 Ordinary Shares were paid up in full. The 10,000 Deferred were issued to the vendors fully paid as the purchase price of the goodwill. On July 1, 19..., 200 6% £100 Debentures were issued at 95 and fully paid up. Interest due on these debentures as on December 31, 19..., had not been passed through the books. In addition to the Ledger Accounts representing the above transactions, the following Ledger balances were extracted from the books of the Company as on December 31, 19...: Machinery and Plant, £14,800; Monotype Machines, £6,860; Freehold Works and Offices, £51,229; Sales, £22,041; Sales (Cash), £982; Advertisement Receipts, £26,518; Jobbing Printing Receipts, £987; Printers' and Compositors' Wages, £13,221; Office Furniture, £680; Cash at Bank, £8,123; Cash in hand, £421; Sundry Creditors, £224; Sundry Debtors, £8,460; Purchases (Ink and Printing Materials), £6,956; Sales Returns, £989; Management and Office Salaries, £3,578; Office Expenses, £397; Advertisement Canvassers' Salaries and Commission, £1,326; Discount Account (Debit balance), £123; Printing Works Expenses, £1,784; Carriage Outwards, £224; Carriage Inwards, £198; Bad Debts, £188; Bad Debts Provision (January 1), £200; Coal and Lighting (Works), £972; Coal and Lighting (Office), £54; Rates, Taxes, Insurance (Works), £424; Rates, Taxes, Insurance (Office), £98; Cost of Literary Contributions, £244; Machinery Repairs, £632; Stock of Type, Plates, etc. (January 1), £12,965; New Type purchased, £1,284; 1,000 £1 Shares in *Loamshire Evening News* purchased at 15*s.* per share, £750; Stock of Paper, Ink, etc. (January 1), £9,872; Motor Vans, £6,500; Directors' Fees, £600.

Prepare Trading and Profit and Loss Accounts for the year ended December 31, 19..., and a Balance Sheet as on that date, taking into account the following: (*a*) Depreciation, Machinery and Plant, 10%, Monotype Machines, 15%; (*b*) £1,000 is to be provided in connection with pending action for libel; (*c*) £120 paid to an injured workman and included in Printers' Wages is recoverable from an Insurance Co.; (*d*) Bad Debts Provision to be increased to equal 5% on Sundry Debtors; (*e*) Stock, Paper, Ink, etc., December 31, 19..., was £8,740. On the same date Motor Vans were £5,800 and Type, Plates, etc., £13,000; (*f*) £2,500 of "Advertisement Receipts" represent unexpired prepaid advertisements, and is to be carried forward to next year; (*g*) the *Loamshire Evening News* went into liquidation, and the shares are to be written off; (*h*) One-fifth of the Debenture

Discount is to be written off; (*i*) No entries have been made in the bool in respect of twelve months' Interest at 5% due upon the calls made i advance.

35. The Rayon d'Or Copper Mining Company was registered on January 19..., with a nominal capital of 100,000 Ordinary Shares of £1 each to wo concessions, for which £50,000 was paid. All the Capital was issued, and 15 per share paid up as on December 31, 19.... One shareholder had also paid u the balance of 5*s.* per share on his holding of 1,000 shares. On July 1, 19..., tl Company issued 100 8% Debentures of £100 each at 105, the issue being ful subscribed and paid up. During the year 19..., a deposit of vanadium was foun and the directors decided to treat all expenditure thereon as capital expenditu pending developments. In addition to the accounts necessary to record the particulars, the following balances were extracted from the Company's books a on December 31, 19...: Buildings, £8,000; Loose Tools, £890; Machinery ar Plant, £19,800; Preliminary Expenses, £1,250; Stock of Stores (January 1 £4,108; Workmen's Wages, £9,872; Workmen's Wages (Vanadium), £1,28 Office Furniture, £800; Carriage and Freight, £4,876; Carriage and Freigl (Vanadium), £1,124; Salaries, £2,910; Salaries (Vanadium), £150; Stor purchased, £3,241; Stores purchased (Vanadium), £1,124; Law Costs, £32 Rates, Taxes and Licences, £1,340; Rates, Taxes and Licences (Vanadium £250; Light Railway Wagons, etc., £10,450; Bills Payable, £981; Bank Ove draft, £5,860; Cash in hand, £984; Sundry Creditors, £4,238; Sundry Debto £12,940; Fuel, £3,496; Fuel (Vanadium), £940; Sales of Copper Ore, £46,08 Marine Insurance, £1,298; Office Expenses, £321; Office Expenses (Vanadiun £50; Directors' Fees, £1,000; Transfer Fees, £5.

Prepare a Working Account for the year ended December 31, 19..., and Balance Sheet as on that date. Before doing so take the following matters in consideration: (*a*) Write off 10% Depreciation from Machinery and Plant, 5 from Office Furniture, and £1,000 from Buildings; (*b*) Stores on hand on Decemb 31, 19..., were valued at £3,876, Light Railway Wagons, etc., at £9,000, and Loo Tools at £600; (*c*) Write off 50% of the preliminary Expenses; (*d*) Create Provisi for Bad Debts equal to 5% of the Sundry Debtors; (*e*) The shareholder who pa his call in advance is entitled to 5% interest thereon for 12 months, but no entri have yet been made; (*f*) Debenture interest due December 31, 1919, has n been passed through the books.

36. The Cosmopolitan Hotel Company, Ltd., was formed to purchase a old-established hotel, and was registered with a nominal capital of £110,00 divided into 50,000 Ordinary Shares of £1 each, 50,000 7% Cumulative Preferen Shares of £1 each, and 10,000 Deferred Shares of £1 each. All the Deferr Shares were issued to the vendors as the purchase price of the Goodwill. Tl Ordinary Shares were issued at par, and the Preference Shares at a premium 2*s.* 6*d.* per share. Both classes of shares were fully subscribed and paid u except that the final call of 5*s.* per share upon 1,000 Preference Shares remain unpaid as on December 31, 19.... On July 1, 19..., 200 6% Debentures of £1 each, repayable at par in ten years, were issued at 95, fully subscribed and pa up. In addition to the accounts represented by the foregoing, the followi ledger balances were extracted from the Company's books, as on December 3 19...: Freehold Hotel, £134,400; Furniture and Fittings, £22,800; Prelimina Expenses Account, £800; *Purchases*—Provisions, £38,726; Wines, Beer, ar Spirits, £22,462; Sundries, £624; Wages of Waiters and Staff, £8,986; Offi Salaries, £827; Hotel Takings, £69,861; Laundry Expenses, £1,794; B Takings, £12,842; Billiards Takings, £416; Carriage Inwards, £347; Laund Receipts, £1,012; Sundry Working Expenses, £1,296; Coal and Lighting, £84 Repairs to Furniture, etc., £2,441; Motor Omnibuses, £2,400; Advertisin £1,575; Discount Account (Credit Balance), £342; Omnibus Receipts, £1,28 Transfer Fees, £5; Stock (January 1), £5,986; Profit and Loss Account, Janua 1, 19... (Credit Balance), £13,842; Sundry Creditors, £1,869; Sundry Debto £798; Directors' Fees, £500; Cash at Bank, £4,864; Cash in Hand, £89 Preference Share Dividend for half-year to June 30, 19..., £1,750; Rates, Tax and Insurance, £2,162; Bad Debts, £96

Prepare Trading and Profit and Loss Accounts for the year ending Decemb

31, 19..., and Balance Sheet as on that date. Before preparing the Accounts make the following adjustments: (*a*) The Debenture Interest due on December 31, 19..., had not been passed through the books. (*b*) As on December 31, 19..., the following amounts were outstanding and had not been provided for: Wages, £126, Salaries, £52, Excess Profits Duty, £2,461. (*c*) Insurance paid in advance amounted to £148 as on December 31, 19.... (*d*) Depreciate Furniture and Fittings, 15% and Motor Omnibuses, 20%. (*e*) The Stock of Wines, Spirits, and Provisions on hand as on December 31, 19..., was valued at £7,221. (*f*) Write £200 off Debenture Discount Account, and £400 off Preliminary Expenses Account. (*g*) Carry £7,500 to a Reserve Account. (*Royal Society Arts.*)

37. The Rugosa Manufacturing Company, Ltd., was registered with a nominal capital of 50,000 shares of £1 each, of which 40,000 shares had been issued and fully called.

The following Trial Balance was extracted as on December 31:—

	£	£
Stock (January 1)	18,642	
Manufacturing Wages	10,974	
Coal and Coke	1,924	
Purchases and Sales	82,146	116,990
Machinery Repairs	861	
Carriage Inwards	491	
Carriage Outwards	964	
Interim Dividend (July 1)	2,000	
Income Tax	1,429	
Bank Loan (5%)		5,000
Interest on Loan	125	
Sundry Debtors and Creditors	16,440	9,222
Profit and Loss Account (Balance from last year)		3,864
Bank Current Account	1,686	
Cash in hand	162	
Leasehold Factory	6,421	
Machinery and Plant	7,840	
Loose Tools	1,250	
Share Capital		40,000
Calls in arrear	100	
Rent, Rates, and Light (Factory, £1,421; Offices, £340)	1,761	
Directors' Fees	1,200	
Office Salaries and Expenses	1,425	
Office Furniture	500	
Commission	864	
Returns	1,264	981
Preliminary Expenses Account	600	
Transfer Fees		42
Goodwill	15,000	
	£176,099	£176,099

You are required to prepare Manufacturing and Profit and Loss Accounts r the year ended December 31, and a Balance Sheet as on that date.

When preparing these accounts, the following matters must be taken into onsideration: (1) Write one-third off the Preliminary Expenses Account.) Write 10% depreciation off Machinery and Plant, and 5% off Office Furniture.) Manufacturing Wages £189, and Office Salaries £120, had accrued due as on ecember 31, but no entries had been made in the books. (4) Provide for the terest due on the Bank Loan for the half-year ended December 31. (5) The ock was valued at £12,484, and Loose Tools at £1,000, as on December 31.) Provide £850 on the Sundry Debtors for bad and doubtful debts. (7) Provide % on the Sundry Debtors for discount.

38. The Windyridge Horticultural Company, Ltd., was registered with a inal capital of 30,000 shares of £1 each, of which 12,500 shares had been ed and fully called up.

The following Trial Balance was extracted from the books of the Company n December 31:—

TRIAL BALANCE.

	£	£
Share Capital Account		12,500
Goodwill	5,000	
Leasehold Warehouse and Offices	5,547	
Loose Tools	700	
Workmen's Wages	2,586	
Rent and Rates (Warehouse, £750; Offices, £120)	870	
Purchases	9,642	
Sales		17,894
Receipts for Constructing Gardens		1,963
Stock (January 1)	3,861	
Purchases Returns		94
Sales Returns	39	
Carriage Inwards	127	
Carriage Outwards	98	
Insurance (Warehouse, £92; Offices, £26)	118	
Office Salaries	697	
Directors' Fees	450	
Discount Account		37
Motor Lorry	1,200	
Office Furniture	320	
Loan on Mortgage, at 10%		2,000
Interest Account and Bank Charges	136	
Calls in arrear	250	
Sundry Debtors	3,742	
Sundry Creditors		2,520
Heating and Lighting (Warehouse, £72; Office, £35)	107	
Advertising	975	
Bank Overdraft		462
Cash in hand	107	
Provision for Bad Debts (December 31, 19..)		300
Profit and Loss Account (Balance from last year)	1,198	
	£37,770	£37,770

You are required to prepare Trading and Profit and Loss Accounts for the r ended December 31, and a Balance Sheet as on that date.

When preparing these accounts, the following matters must be taken into sideration: (*a*) Office Salaries, £32, had accrued due as on December 31, but l not been passed through the books. (*b*) Insurance (Warehouse), £12, had n paid in advance. (*c*) Interest for the half-year to December 31 on the rtgage had accrued due, but had not been passed through the books (ignore ome Tax). (*d*) The following depreciation is to be provided: Motor Lorry, %; Loose Tools, 25%; Office Furniture, 5%. (*e*) The Provision for Bad Debts o be increased to £400. (*f*) The Stock on hand as on December 31 was valued £4,062.

39. The Pernet Manufacturing Company, Ltd., was registered in 19... with a

On January 1, 19..., the Company took over the assets and liabilities of Lamia, Ltd., at their book values, which were as follows: Sundry Debtors, £16,136; Sundry Creditors, £3,862; Stock, £14,850; Machinery and Plant, £10,890; Cash, £1,986.

The purchase price was agreed at £50,000, and was satisfied by the issue of 50,000 Ordinary Shares in the Pernet Company issued to the Lamia Company as fully paid.

On July 1, 19..., 200 5% Debentures of £100 each were issued at 95.

In addition to the records arising out of the above particulars, the following balances were extracted from the books of the Company as on December 31, 19...:—

Machinery and Plant, £32,765; Machinery and Plant, Additions during the year, £8,456; Leasehold Works, £77,841; Manufacturing Wages, £86,968; Profit and Loss Account (Debit Balance from last year), £7,862; Sinking Fund for Leasehold Redemption, £8,850; Sundry Debtors, £12,460; Sundry Creditors, £35,503; Stock (January 1), £32,641; Factory Power and Light, £3,642; General Expenses, £4,785; Purchases, £76,495; Uncompleted Contracts (January 1), £13,844; Unpaid Calls (Ordinary Shares), £500; Returns Inwards, £864; Returns Outwards, £3,241; Loose Tools, £2,864; Machinery and Plant sold during the year, £5,641; Management Salaries, £3,522; Machinery Repairs, £1,267; Office Salaries, £3,842; Directors' Fees, £750; Office Furniture, £684; Discount Account (Debit Balance), £174; Provision for Bad Debts (January 1), £500; Travellers' Salaries and Commission, £6,894; Carriage on Purchases, £3,641; Carriage on Sales, £4,846; Transfer Fees, £146; Sales, £169,159; Cash at Bank, £3,246; Cash in hand, £1,187; Loan from Bank, £15,000; Patents, £20,000.

You are required to prepare Manufacturing and Profit and Loss Accounts for the year ended December 31, 19..., and a Balance Sheet as on that date.

When preparing these accounts, the following matters must be taken into consideration: (*a*) No provision has been made for the Debenture Interest due on December 31. (*b*) As on December 31, the following items were due but not recorded in the books: Wages, £996; Office Salaries, £226; and Directors' Fees, £750. (*c*) Manufacturing Wages, £541, were paid to workmen employed in making Loose Tools for the Company's use, but the requisite transfer had not been made. (*d*) The Manufacturing Account is to be charged with two-thirds of General Expenses and Management Salaries. (*e*) Provide £500 for fine under an uncompleted contract now subject to litigation. (*f*) The following valuations were made as on December 31: Machinery and Plant, £32,640; Loose Tools, £2,951; Office Furniture, £600; Stock, £28,740; and Uncompleted Contracts, £9,641. (*g*) Reserve 2½% for Travellers' Commission outstanding on December Sales, which were £13,960. (*h*) The Bad Debts Provision is to be made equal to 5% on the Sundry Debtors.

40. The Ramshackle Motor Co., Ltd., acquired the undertaking of Messrs. Smith Bros., Ltd., as at the end of 19.... The following Statement of Accounts, made up to June 30 following, is submitted to you for audit. Criticise the statement, taking at least six points (three on the Balance Sheet and three on the Trading and Profit and Loss Account).

BALANCE SHEET.

DR.		£		CR. £
To Capital		250,000	By Freehold and Buildings	87,650
" £30,000 5% Morgtage Debentures issued at 10% Discount		27,000	" Goodwill, Patents, Patterns, Plant, and Work in progress	74,342
" Creditors—			" Fixtures and Fittings (Office)	232
On Open Account	£16,444		" Investments	4,732
Debenture Interest	1,500		" Cash at Bank and in hand	12,411
		17,944	" Capital unissued	25,770
" Provision for Bad Debts		279	" Debtors	2,075
			" Stock	84,784
			" Suspense Account	3,227
		£295,223		£295,223

TRADING AND PROFIT AND LOSS ACCOUNT.

	£		Cr. £
ock acquired from Vendors	21,441	By Sales	10,418
ırchases	58,937	„ Amounts paid on forfeited shares	385
ages	4,392	„ Appreciation in value of Securities	219
ıtes and Taxes	1,174	„ Stock, June 30, 19...	84,784
ebenture Interest	1,500	„ Balance carried to Suspense Account	392
ıel and Lighting	1,052		
ırtage	589		
fice Expenses	3,441		
ıd and Doubtful Debts	279		
eliminary Expenses	2,143		
rectors' Fees	1,250		
	£96,198		£96,198

1. G. Emblem is a motor-car and cycle dealer. He divides his business into
departments, viz. Motors ("M") and Cycles ("C").

)n March 31, 19..., the following balances were extracted from Emblem's
ts:—

Stock at beginning of year ("M," £12,812; "C," £3,210), £16,022; Purchases
," £22,714; "C," £9,222), £31,936; Workshop Wages ("M," £3,218; "C,"
), £4,142; Workshop Rent and Rates ("M," £850; "C," £250), £1,100;
kshop Power, Light, and Heating ("M," £621; "C," £182), £803; Travellers'
ries and Commission, £4,683; Office and Showroom Salaries, £3,846; Office
Showroom Expenses, £1,242; Workshop Expenses ("M," £1,262; "C,"
), £1,603; Capital Account (March 31, 1950), £30,000; Leasehold Workshop
Offices, £3,264; Additions to Workshop during the year, £1,862; Machinery
Plant, £5,740; Loose Tools (March 31, 19...), £1,282; Bad Debts Provision
rch 31, 19...), £678; Discount Account (Credit Balance), £372; Income Tax
Excess Profits Duty, £2,841; Sundry Debtors, £9,780; Sundry Creditors,
941; Sales ("M," £33,892; "C," £12,225), £46,117; Purchases Returns
," £1,281; "C," £191), £1,472; Sales Returns ("M," £842; "C," £47),
; Apprentices' Fees ("M," £400; "C," £100), £500; Insurance, Workshop
," £1,842; "C," £421), £2,263; Motor Lorries, £1,880; Interest and Bank
rges, £873; Office Furniture, £560; Carriage Inwards ("M," £1,082; "C,"
), £1,378; Distribution and Advertising Expenses, £5,895; Office and
wroom Rent and Rates, £585; Bills Payable, £1,526; Drawings Account
Emblem), £1,000; Cash in hand, £137; Bank Loan, £10,000.

You are required to prepare Trading and Profit and Loss Accounts for the
ended March 31, 19..., and a Balance Sheet as on that date. The Trading
Profit and Loss Accounts are to be prepared in columnar form, showing the
lts of the year's working in each department. The Profit and Loss items
to be apportioned as to two-thirds to "M" department and one-third to
" department.

When preparing these accounts, the following matters must be taken into
ideration: (*a*) On March 31, 1951, the following valuations were made:
k, "M," £10,726; "C," £2,010; Motor Lorries, £1,700; Loose Tools, £1,000.
The following depreciations are to be provided for: Machinery and Plant,
; Office Furniture, 10%; Workmen's Wages ("M" department), £121,
been paid for time in making loose tools, and wages, £46 ("C" department),
been paid to an injured workman on behalf of an Employers' Liability
ırance Company, by whom it was still owing. (*c*) Insurance was paid in
ance as follows: "M" department, £181; "C" department, £56. (*d*) £100
rentices' Fees ("M" department) is to be carried to next year as fees received
dvance. (*e*) Interest on capital at 5% is to be charged, but no interest is to
charged on drawings. (*f*) An amount equal to 5% on the Sundry Debtors is

BALANCE SHEET, DECEMBER 31, 19....

Dr.	£	£	Cr.		£
Issued Share Capital	190,000		Leasehold Land, Buildings and Machinery at cost		200,00
Less Calls in arrear	8,000		Railway, Wharf, Motor Boats, Live Stock, etc., at cost	£12,000	
		182,000	*Less* Depreciation	500	
Bank Loan		48,000			11,50
Sundry Creditors		3,647	Expenditure on 19.. Crop to date		45,10
Bills Payable		32,100	Expenditure on 19.. Crop to date		68
Profit and Loss Account—			Advances to Coolies and Sundry Debtors		6,85
Profit for the year	9,120		Exchange Suspense Account		39
Less Interim Dividend paid	9,100		Cash on Plantation		1,85
		20	Cash at Bankers in London		1,09
Depreciation Fund		5,000			
		£270,767			£270,76

You are asked to criticise this Balance Sheet from the point of view of a prospective shareholder. If you desire any further information before giving your opinion, submit the letter which you would address to the secretary of the company. (*Chartered Institute Secretaries.*)

43. Define: "Contingent Liability," "Collateral Security," and state how you would treat them in the Final Accounts of a firm. (*Incorporated Accountants.*)

44. Briefly explain the information contained in the under-mentioned registers as employed by limited companies: Register of Charges; Register of Transfers; Register of Probates and Administrations; Register of Balance Certificates.

Submit the ruling of *one only* of these registers, and make a specimen entry therein. (*Royal Society Arts.*)

CHAPTER XIII

AN INTRODUCTION TO CONSOLIDATED ACCOUNTS

E reference was made in the last chapter to the nature and growing
ortance of Consolidated Accounts, and the fact that the Companies
, 1948, has, for the first time, afforded them legal recognition. In
present chapter we will commence by studying the statutory
iirements laid down by the Act and then go on to consider some
ple practical examples. The word " simple " is here used deliber-
y, since the accountancy work involved in complex cases can
ome intricate and difficult, and the consideration of such cases in
thing like an exhaustive manner would take up more room than is
ilable in this volume. On the other hand, it is a mistake for the
lent to start under the impression that, because the subject can
sent difficult problems and even some points on which qualified
ountants can hold differing opinions, it is one for him to be afraid
The main principles are quite straightforward, and should be
ly enough understood if a fair start is made at the beginning. It
oped that this chapter will give that start.

The first point of all is that a Consolidated Profit and Loss Account
statement combining (in some manner) the information contained
wo or more (in complex cases numerous), Profit and Loss Accounts.
ilarly, as regards the Consolidated Balance Sheet. Whereas an
inary Profit and Loss Account is an integral part of the system of
inary double-entry book-keeping, being, in fact, the account into
ch all the ledger accounts dealing with income and expenditure
periodically closed, and from which appropriations to Reserves and
idend Accounts are made, this is not true of the consolidated
ement. It does not correspond at all to entries in any (single) set
double-entry books, and obviously cannot form any part of the
inary double-entry system. No " postings " can be made to or
n it. On the other hand, whereas the ordinary Balance Sheet,
ether " statutory " or otherwise, is no more than a statement listing,
a more or less prescribed manner, all the balances remaining on a
of double-entry books after the Profit and Loss Account has been
sed off, the Consolidated Balance Sheet is a statement listing in a
newhat similar manner, the balances remaining on two or more sets
books.

Consolidation would have no point, and would merely be confusing
l meaningless, unless the sets of books in question belonged to
ated businesses. It is done only where the companies in question
m what is known as a " group," and even then only where certain
[illegible] A portion of the shares in each member of the

defines the circumstances under which the statutory rules as to consolidated statements apply. It limits the relationship to those cases in which either: (*a*) the holding company is a member of the subsidiary and controls the composition of its board of directors, or (*b*) it holds *more than* half in nominal value of the equity share capital of the subsidiary, or (*c*) the subsidiary is a subsidiary of another company, which is itself a subsidiary of the holding company.

We need not consider examples of case (*a*), which will be comparatively rare, beyond remarking that the holding of a single share constitutes membership, and that consequently if Company A holds one, and only one, share in Company B, and if that share carries the right to appoint directors of B, then B is a subsidiary of A.

Case (*b*) is the simple one where Company A holds *more than* half the equity capital of B. The expression "equity share capital" as here used is defined by S. 154 (5) as meaning its issued share capital *excluding* any part thereof which neither as respects dividends nor as respects capital, carries any right to participate beyond a specified amount in a distribution. This may be worth illustrating:—

Case (1). The capital of B, Ltd., consists of 100,000 5% Cumulative Preference Shares and 10,000 Ordinary Shares all of £1. The Preference Shares carry a right to a dividend of 5% and no more, and on liquidation they are entitled to a fixed capital sum (say 25s. per share), and no more. Here the Ordinary Shares constitute the "equity" capital, and if A, Ltd., holds 5,001 of the ordinary shares, then B is a subsidiary of A, quite regardless of how the preference shares are held. On the other hand, if A, Ltd., held 4,999 (or even 5,000) Ordinary Shares and no more in B, Ltd., then B, Ltd., would not be a subsidiary of A, Ltd., even though A, Ltd., were to hold all preference shares of B, Ltd. (unless, of course, the preference shares carried voting rights which gave their holders control of the board, when the case would come under (*a*).

Case (2). Suppose the circumstances are as in Case (1) except that the Preference Shares of B, Ltd., have "participating" rights as to dividend, limited to (say) 10% in any one year. The 10% is a "specified amount," and consequently the Preference Shares still do not constitute "equity capital." The rule as to shareholding therefore remains exactly as in Case (1).

Case (3). The circumstances are as in Case (2), but now suppose the participating rights are to a stated fraction of whatever dividend is paid on the Ordinary Shares, no limit being stated. The Preference Shares are now "equity capital," and since the total value of shares in issue is £110,000, in order that B, Ltd., may be a subsidiary of A, Ltd., A, Ltd., must hold not less than 55,001 shares. Obviously these cannot all be Ordinary, since there are not sufficient in issue: they may be partly Preference and partly Ordinary or all Preference.

It should be noted that the Act refers only to the "nominal" value of the capital, and apparently it is immaterial whether the shares in question, or some of them, are only partly paid.

We come now to case (*c*), which in effect lays down that if B is a subsidiary of A, and C is a subsidiary of B, then C is itself to be regarded a subsidiary of A. This leads to some interesting consequences, the)st obvious of which is that a "chain" can be formed. If D is a ɔsidiary of C, in the case considered, and C, by virtue of the rule, is ;ubsidiary of A, then by the same rule D must itself be a subsidiary A. The same principle extends indefinitely, and so long as the chain ɪnbroken then every company in it is a subsidiary of every company the chain above it. C is sometimes termed a sub-subsidiary of A, t the term is not statutory.

When Group Accounts are Necessary.—The question whether an ligation is laid on every holding company to prepare group accounts pends on whether or not the company in question is a "wholly ned" subsidiary of its immediate holding company, and whether ɪt company is incorporated in Great Britain. Group accounts are t required if the (holding) company is a wholly owned subsidiary of other company incorporated in Great Britain (S. 150 (2) (*a*)). rther, group accounts, even when prepared, may omit to deal with rticular subsidiaries under certain stated circumstances, *e.g.* if the ıount involved is insignificant, or if the result would be misleading or rmful to the business or any of its subsidiaries or if the businesses the holding company and its subsidiaries are so different that they ɪnot reasonably be regarded as a single undertaking (S. 150 (2) (*b*)).

A wholly owned subsidiary is a subsidiary *all* the shares of which ; held by the holding company, not merely the equity. There are ɜrefore no "outside" shareholders of the subsidiary, and if B owns the shares of C and is itself a subsidiary of A it is clear that no useful rpose would be served by compelling B to prepare group accounts B and C), since there is no one to see such accounts except members A, which must, of course, prepare group accounts dealing with all ree companies. On the other hand, if there is a chain of companies, B, C, D, each of which in turn is a subsidiary of the one named before d each of which has some outside shareholders, then C must prepare)up accounts to deal with C and D, B must prepare group accounts deal with B, C, and D, and A must prepare group accounts to deal th all four businesses.

The Form of Group Accounts.—This is dealt with in S. 151. In rmal cases the group accounts are to consist of: (*a*) a Consolidated lance Sheet dealing with the state of affairs of the company and all ; subsidiaries to be dealt with (that is to say excluding non-consoli- ted subsidiaries), and (*b*) a Consolidated Profit and Loss Account aling with the profits and losses of the same companies. If, however, ; directors think some other method is better because it would present ; same information in a form more readily appreciated, they may opt that other method; in particular, the accounts may be split, e set dealing with the company itself and some of its subsidiaries, d another dealing with other subsidiaries, or separate accounts may

However, if group accounts are not submitted, the specific information called for by the Eighth Schedule, para. 15 (4), (5), and (6) (see p. 530) must be given.

The group accounts, however prepared, must give " a true and fair view of the state of affairs and profit and loss of the company and its subsidiaries dealt with thereby as a whole, so far as concerns members of the company " (S. 152 (1)), and must comply with the requirements of the Eighth Schedule so far as applicable (S. 152 (3)).

A holding company which submits a Consolidated Profit and Loss Account dealing with *all* its subsidiaries and which complies with the requirements of the Act relating to Consolidated Profit and Loss Accounts is excused from the provisions of S. 149 (1) and the Eighth Schedule as applying to its own (separate) Profit and Loss Account (S. 149 (5)). The Consolidated Profit and Loss Account must, however, show how much of the consolidated profit or loss for the financial year is dealt with in the accounts of the holding company. Many holding companies have taken advantage of this provision, and submit a Consolidated Profit and Loss Account only, without a separate account showing the profit or loss of the holding company. The method is obviously convenient.

Financial Year of Subsidiary.—The holding company's directors must arrange that, unless in their opinion there are good reasons against it (which in practice are most likely to occur as regards foreign subsidiaries), the financial year of each subsidiary is to coincide with the holding company's own financial year (S. 153). The desirability of this rule is obvious. If a Consolidated Balance Sheet includes assets of the holding company as on one date and a subsidiary as on another date it cannot be strictly said to give a true picture of anything: it may be necessary to make adjustments which are to some extent estimates and which may give considerable difficulty from an accounting point of view, and the result can never be entirely satisfactory. Before 1948 it was occasionally, though probably rarely, done.

Where the financial year of a subsidiary does not (notwithstanding the foregoing) coincide with that of the holding company the group accounts must (unless the Board of Trade otherwise direct in that particular case) deal with that subsidiary as at the end of its financial year ending last before that of the holding company (S. 152 (2)).

Specific Rules as to Accounts of a Holding Company.—Apart from the general requirements already referred to, Part II of the Eighth Schedule lays down certain regulations. These fall into two parts, the first of which contains rules concerning the holding company's own " statutory " accounts, while the second deals with the group accounts. The first set of rules, which apply to the company's separate accounts, apply whether or not the holding company is itself a subsidiary of another company (para. 15 (1)). They are to the following effect:—

Para. 15 (2). There are to be disclosed separate aggregate totals of (the book value of) shares in the company's subsidiaries, indebtedness (whether by way of loan or otherwise) by the subsidiaries to the mpany, and indebtedness to the subsidiaries by the company. The les in Part I of the Schedule as to the statement of the company's vestments or fixed assets are not to apply to the above.

Para. 15 (3). There must be shown by way of note the number, scription, and amount of shares in or debentures of the (holding) mpany held by the subsidiaries. In this connection it is provided 27, which came into force on July 1, 1948) that a company cannot a member of a company which is its holding company, and any otment or transfer of shares in a company to its subsidiary shall be id (unless the subsidiary is concerned as personal representative or istee, and the holding company is not beneficially interested in the ıst). No similar provision applied before July 1, 1948, however, and 27 (3) provides that if at that date a subsidiary was a member of its lding company it may continue to hold the shares it already had ıt not to acquire any more), but shall have no right to vote in pect of them at meetings of the holding company. The rule laid wn in para. 15 (3) is that such holdings, where they exist, must be closed by a note in the accounts of the holding company.

Para. 15 (4) and (5), which apply only where group accounts are submitted. A statement is to be annexed to the accounts setting t: (*a*) the reason why group accounts are not submitted; (*b*) the net gregate amount of the revenue profits (less losses) of the subsidiaries far as they concern members of the holding company and are not alt with in that company's accounts, for (i) the current financial year d (ii) all past financial years since the companies became subsidiaries; similar statements as to the net aggregate revenue profits (less ses) of subsidiaries so far as they have been dealt with in the holding npany's accounts; and (*d*) any qualifications in the reports of the ditors of the subsidiaries on their accounts for the various financial ırs mentioned above. Pre-acquisition profits or losses are to be cluded from the figures required by (i) and (ii), since from the point view of the holding company they are of a capital nature.

Para. 15 (6). Where group accounts are not submitted, there is to annexed to the company's Balance Sheet a statement showing, as ards subsidiaries whose accounting years do not coincide with the lding company's accounting year: (*a*) the reasons why the directors ısider that these financial years should not coincide, and (*b*) the tes of the various subsidiaries' financial years.

Accounts of a Subsidiary.—Para. 16. The Balance Sheet of a npany which is itself a subsidiary (whether or not it itself is a holding npany) must show the aggregate amount of indebtedness to all npanies of which it is a subsidiary or a fellow subsidiary, also the gregate amount of indebtedness of all such companies to it, distinishing separately any indebtedness in respect of Debentures. A npany is defined as being a fellow subsidiary of another company if th are subsidiaries of a third company, but without either being a following paragraphs the Consolidated Balance Sheet and Profit and Loss Account must combine the information contained in the separate Balance Sheets and Profit and Loss Accounts, but with such adjustments as the directors of the holding company think necessary.

Paras. 18 and 19. The consolidated accounts are, as far as possible, to comply with all the requirements of the Act applying to the accounts of an actual company. But these requirements are not to include the provisions of SS. 196 and 197, which deal with the disclosure of directors' salaries, pensions, etc., and loans to officers of the company. This exception is because it is laid down in the sections in question that this information is to be given in, or annexed to, the accounts of the holding company itself. To set it out again in the consolidated accounts would therefore involve an unnecessary repetition.

Para. 21. In regard to subsidiaries not consolidated, the rules laid down by para. 15 (2) and (3) (which relate to the disclosure of shareholdings and indebtedness) are to apply as though the consolidated accounts were the accounts of an actual company of which the non-consolidated companies were subsidiaries, and the rules laid down by para. 15 (4) (as to profits, etc.) are to apply similarly.

Para. 22. In relation to any subsidiaries, whether consolidated or not, the ends of whose financial years do not coincide with that of the company, the rules laid down by para. 15 (6) are to apply as though there were no consolidated accounts.

Auditors' Report.—The auditors are not required to report separately on the consolidated accounts. The consolidated accounts are, by S. 156, required to be included among the documents annexed to the company's own Balance Sheet and, by S. 162, are among the accounts on which the company's auditors are required to report. The auditors, however, make only one report, which deals with the whole of the various accounts they have examined. The matters required to be expressly stated in this report are detailed in the Ninth Schedule, and, in the case of a holding company submitting group accounts, the auditors are to state " whether, in their opinion, the group accounts have been properly prepared in accordance with the provisions of the Act so as to give a true and fair view of the state of affairs and profit and loss of the company and its subsidiaries dealt with thereby, so far as concerns members of the company."

Accountancy—Method of Preparing Consolidated Accounts.—Alhough, as stated earlier, consolidated statements form no part of the ormal book-keeping of a business, nevertheless, double-entry principles may still be applied. In simple cases this is not really necessary, but where there is a large mass of figures to deal with the application of omething like double-entry principles is a great aid, both to accuracy nd clear thinking, and is strongly recommended. The usual method to tabulate all the figures to be dealt with, using a separate column or each subsidiary being dealt with. The sheet, called a " Consolidatng Schedule," is in ledger form, with Dr. and Cr. sides. Each subsidiary has its own column on both the Dr. and Cr. sides, and there is on each side an additional column for adjustments and a "total" column. Separate sheets should be used for the Profit and Loss Account and for the Balance Sheet. Any adjustments to be made are first entered on a special journal sheet, which may be in ordinary "journal" form, and from there "posted" to the "adjustment" column in the Schedules. As it is more than likely that some, at least, of the adjustments will need to be referred to when preparing consolidated accounts in future years the journal entries should be accompanied by full "narrations" and references to any other records used or consulted, and all entries, whether in the journal or schedules should be clear and self-explanatory. Folio references between journal and schedule, the latter against the "adjustments" column, are advisable, and the best plan is probably to number each journal entry consecutively. For the sake of permanence and ease of future reference there is much to be said for keeping all these records in book form, rather than on loose sheets. The method of use is exemplified in the illustration on p. 542.

The method of proceeding will probably by now be tolerably clear to the reader. All figures appearing in the final accounts of each company being dealt with, whether in the Profit and Loss Account or Balance Sheet, are first entered, in full detail, in the column allocated to that company, debits in the debit column, and credits in the credit. Since the original accounts balance, the columnar totals will agree, the Profit and Loss and Balance Sheet schedules separately. Since all adjustments originate in the journal, debit and credit sides of each entry in which must agree in total, the final totals of the entries in the adjustment column in the ledger must also agree, debit with credit. It should be mentioned at this stage that "negative" entries, *e.g.* a credit adjustment to an account having a debit balance, are best entered in red ink and thereafter treated as deductions (a standard convention often used in ordinary book-keeping). When the above has been carried out, each "account" is cross cast, deducting any negative entries of course, and the balance extended to the "total" column. It will be clear from the method of proceeding that since the otals of all corresponding columns agree in pairs, including the totals of the "adjustment" columns, the totals of the "total" columns must agree with the sum of the totals of the subsidiary columns, and so with each other. If they do not, some slip or omission has been made, which must be searched for. Finally, the figures in the "total" column are used to compile the Consolidated Profit and Loss Account and Balance Sheet.

One final remark should be made. Although, in the columns allocated to the individual companies, one entry will appear against each heading, there may very well be more than one entry on the corresponding "line" of the "adjustment" column. Such adjusting entries must necessarily appear underneath each other, and sufficient pace should therefore be left when planning the original lay-out to accommodate such entries without trespassing on a "line" allocated

The writer realises that it is extremely unlikely that a student will be set an examination question sufficiently complicated to demand the use of this method—exigencies of time would hardly allow of it—nevertheless, its principle is worth understanding. The working of a few practical examples will emphasise the nature of the task in hand and show where its difficulties lie.

Here follow a few examples of the construction of Consolidated Profit and Loss Accounts and Balance Sheets, commencing with the simplest possible. Points of principle arising in the different cases will be dealt with in discussing the illustration in question. It will be seen that, in order to save space and unnecessary detail, a certain amount of condensation has been resorted to, but not, the author hopes, to such an extent as to cause any doubt or confusion: the principle example of this is that "fixed assets" have generally been shown in the Balance Sheets as a single total: in practice, the different types would, of course, be set out separately. "Comparative" figures have been ignored throughout.

Illustration 1.—B, Ltd., is a wholly owned subsidiary of A, Ltd., each company having one class of capital only. B, Ltd., is engaged in trade, while A, Ltd., is a "holding" company only, not trading at all: there are therefore no trading transactions at all between A, Ltd., and B, Ltd. Moreover, A, Ltd., has owned all the shares in B, Ltd., ever since the latter company was incorporated. Both companies prepare accounts to December 31 annually, and their respective Profit and Loss Accounts for the year ended December 31, 19..., and Balance Sheets as on that date are given on pp. 534–535.

Here there are no adjustments at all, and no explanation is needed ıs to how the figures in the consolidated accounts are arrived at. The lisclosure of the "split" of the final balance of consolidated profit .ppears to be necessary in order to comply with S. 149 (5) (*b*), that is n the assumption that the Profit and Loss Account of A, Ltd. (alone) s not to be included in the accounts laid before the members. Regard-ıg the two companies as a single undertaking, as is here done, the hares in B, Ltd., do not, of course, appear at all, being purely an ıternal affair, nor does the inter-company indebtedness. There is no ule as to the precise headings of the accounts: the Balance Sheet ıight be headed "Consolidated Balance Sheet of A, Ltd., and its holly owned subsidiary, B, Ltd., December 31, 19..." There is no ompulsion, though it is natural, to name the subsidiaries where there re only one or two: where there are many it is not practicable.

The consolidated accounts might be drawn up as shown on . 536–537.

Illustration 2.—In this illustration two additional points have been introduced. C, Ltd., is the holding company, and D, Ltd., is its only subsidiary. We are supposing that C, Ltd., holds all the Ordinary Shares in D, Ltd. (*i.e.* the whole of the equity), but that D, Ltd., has also issued Preference Shares, none of which are held by C, Ltd., and Debentures. As in *Illustration* 1, C, Ltd., has held the Ordinary Shares in D, Ltd., since the incorporation of that company, paying for them at par, but (unlike *Illustration* 1) C, Ltd., is a trading company

.td.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...*

l. CR.

	£	s.	d.		£	s.	d.
undry Administrative Expenses	80	0	0	By Dividends from B, Ltd., *less* tax	3,630	0	0
irectors' fees	100	0	0				
udit Fee	20	0	0				
alance carried down	3,430	0	0				
	£3,630	0	0		£3,630	0	0
ransfe o General Reserve	1,000	0	0	By Balance from last year	1,490	0	0
ropose l Dividend, 10% *less* tax	2,200	0	0	" Balance brought down	3,430	0	0
alance carried forward	1,720	0	0				
	£4,920	0	0		£4,920	0	0

* This account is not "statutory" and need not be laid before the members, since the Consolidated Profit and Loss Account is sufficient (S. 149 (5)).

Ltd.

BALANCE SHEET, DECEMBER 31, 19...

R. CR.

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
ninal Capital :—							*Fixed Assets :—*						
0,000 Shares of £1 each	£50,000	0	0				Investment in wholly owned subsidiary company: 30,000 shares in B, Ltd., at cost				30,000	0	0
ed and Fully Paid Capital :—							*Current Assets :—*						
0,000 Shares of £1 each				40,000	0	0	Dividend Receivable from Subsidiary Company	3,630	0	0			
enue Reserves :—							Loan to Subsidiary Company	16,217	0	0			
eneral Reserve	6,000	0	0				Balance at Bank	108	0	0			
rofit and Loss Account	1,720	0	0	7,720	0	0					19,955	0	0
rent Liabilities :—													
xpenses accrued	35	0	0										
roposed Dividend	2,200	0	0	2,235	0	0							
				£49,955	0	0					£49,955	0	0

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	Cr.	£	s.	d.
To Depreciation	750	0	0	By Trading Profit for the year	8,230	0	0
,, Managing Director's Salary	600	0	0				
,, Audit Fee	50	0	0				
,, Balance carried down	6,830	0	0				
	£8,230	0	0		£8,230	0	0
To Income Tax on the year's profits	3,180	0	0	By Balance from last year	115	0	0
,, Proposed Dividend, 22% *less* tax	3,630	0	0	,, Balance brought down	6,830	0	0
,, Balance carried forward	135	0	0				
	£6,945	0	0		£6,945	0	0

B, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

Dr.	£	s.	d.	£	s.	d.	Cr.	£	s.	d.	£	s.	d.
Nominal Capital :—							*Fixed Assets* (detailed) :						
50,000 Shares of £1 each	50,000	0	0				At cost	45,600	0	0			
Issued and Fully Paid Capital :							*Less* aggregate depreciation	7,850	0	0			
30,000 Shares of £1 each				30,000	0	0					37,750	0	0
Revenue Reserves :—							*Current Assets* :—						
Income Tax 19.2/3	3,180	0	0				Stock, as valued by the Managing Director.	17,890	0	0			
Profit and Loss Account	135	0	0				Trade Debtors, *less* provision for doubtful debts	3,070	0	0			
				3,315	0	0					20,960	0	0
Current Liabilities :—													
Trade Creditors and Expenses accrued	1,640	0	0										
Income Tax 19.1/:	2,830	0	0										
Loan from A, Ltd.	16,217	0	0										
Proposed Dividend	3,630	0	0										
Bank Overdraft	1,078	0	0										
				25,395	0	0							
				£58,710	0	0					£58,710	0	0

Ltd., and B, Ltd.

CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£ s. d.	£	s.	d.	Cr.	£	s.	d.
Depreciation		750	0	0	By Trading Profit for the year . . .	8,150	0	0
Directors' Remuneration :								
Directors' Fees . . .	100 0 0							
Management . . .	600 0 0							
		700	0	0				
Audit Fees		70	0	0				
Balance carried down		6,630	0	0				
		£8,150	0	0		£8,150	0	0
Income Tax on the profits of the year .		3,180	0	0	By Balance from last year	1,605	0	0
Transfer to General Reserve . . .		1,000	0	0	,, Balance brought down	6,630	0	0
Proposed Dividend, 10% *less* tax . .		2,200	0	0				
Balance carried forward :								
In the books of A, Ltd. .	1,720 0 0							
,, ,, B, Ltd. .	135 0 0							
		1,855	0	0				
		£8,235	0	0		£8,235	0	0

***Note** (for the reader only, not for publication).*—The Trading Profit with which the above account opens is the profit of B, Ltd., ,230, *less* the administrative expenses of A, Ltd., which need not be disclosed, and there would be no object in disclosing, the consolidated account.

A, Ltd., and B, Ltd.

CONSOLIDATED BALANCE SHEET, DECEMBER 31, 19...

Dr.

	£ s. d.	£	s.	d.
Authorised Capital :—				
50,000 shares of £1 each	50,000 0 0			
Issued and Fully Paid Capital :—				
40,000 shares of £1 each		40,000	0	0
Revenue Reserves :—				
General Reserve	6,000 0 0			
Income Tax 19.2/3	3,180 0 0			
Profit and Loss Account	1,855 0 0			
		11,035	0	0
Current Liabilities :—				
Trade Creditors and Expenses accrued	1,675 0 0			
Income Tax 19.1/2	2,830 0 0			
Proposed Dividend	2,200 0 0			
Bank Overdraft	1,078 0 0			
		7,783	0	0
		£58,818	0	0

Cr.

	£ s. d.	£	s.	d.
Fixed Assets (detailed in practice) :—				
At cost	45,600 0 0			
Less Aggregate Depreciation	7,850 0 0			
		37,750	0	0
Current Assets :—				
Stock, as valued by the Managing Director	17,890 0 0			
Trade Debtors, *less* provision for doubtful debts	3,070 0 0			
Balance at Bank	108 0 0			
		21,068	0	0
		£58,818	0	0

Note.—The bank overdraft must be shown in full (Eighth Schedule, para. 8 (1) (*d*)). This part of the Schedule applies equally to Consolidated Balance Sheets, and consequently it would not be permissible to deduct the balance of A, Ltd.'s bank balance in hand, disclosing only the net overdraft.

and buys goods from D, Ltd., which we suppose manufactures them. D, Ltd., naturally makes a profit on the goods it sells, including the goods sold to C, Ltd.

The method of setting out the preference capital and the debentures ppears in the illustration. The selling of goods by D, Ltd., to C, td., raises a point of principle, in connection with the valuation of ock. In the statutory Balance Sheet of C, Ltd., (alone) stock is sumed to be valued (very properly) at its cost to C, Ltd., but, as gards goods which C, Ltd., has brought from D, Ltd., this is D, Ltd.'s lling price and includes D, Ltd.'s profit on such goods. If therefore iere are at the Balance Sheet date any unsold goods in the possession C, Ltd., which that company had bought from D, Ltd., it would be correct for the purpose of group accounts to value them at the price which C, Ltd., bought them from D, Ltd. They should be valued, ot at their cost price to C, Ltd., but at their cost price to the group, hich is D, Ltd.'s manufacturing cost. This is not the place to discuss ethods of costing, so we will merely assume a figure and take it that has been arrived at by a proper method: in practice it would not be orth while "splitting hairs" in a matter of this sort, unless at any te the figure in question happened to be large.

The assumed Profit and Loss Accounts and Balance Sheets of C, td., and D, Ltd., are on pp. 539–541.

Taxation being outside the scope of this chapter, all figures arising om taxation have been omitted from this and the following examples, also have all references to the authorised capitals of the several mpanies in question. This raises no points of principle, and the ader will by now be aware that in every real Balance Sheet the tails of the authorised capital must be shown. Similarly, it is sumed that in each case the audit fees have been settled at the nual general meetings of the companies in question: consequently, ey need be nowhere disclosed in the accounts (Eighth Schedule, ara. 13).

Before setting out the consolidated accounts, there is one further djustment to explain, which, though it might well be omitted in an xamination question, would be almost certain to arise in a practical se. This relates to the "inter-company" profit on unsold stock at e end of the previous year. The necessity for the elimination of this ter-company profit from the group profit at the end of the current ear has already been explained and, of course, similar adjustments ill have been made in previous years, the figure involved, however, eing different on each occasion. At the end of the last previous counting year the aggregate effect of such adjustments will have been decrease (*a*) the balance of group profit and loss carried forward, and) the value of group stock in the Balance Sheet, in each case by the mount of the inter-company profit included in the combined stock aluations at the date in question. We will now assume that the djustment in question (*i.e.* at the end of the previous year) was 1,950, which is less than the corresponding adjustment at the end of

C, Ltd.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED MARCH 31, 19..

Cr.					Dr.			
	£ s. d.	£	s.	d.		£	s.	d.
To Depreciation of Fixed Assets		650	0	0	By Trading Profit for the year	8,410	0	0
,, Directors' Fees	500 0 0				,, Dividend from Subsidiary Company	2,500	0	0
,, Managing Director's Salary and Commission	2,270 0 0				,, Interest from Investments	400	0	0
		2,770	0	0				
,, Company's Contribution to Staff Pension Fund		385	0	0				
,, Balance carried down		7,505	0	0				
		£11,310	0	0		£11,310	0	0
To Transfer to Reserve against Stock Price Reduction		2,000	0	0	By Balance from last year	1,320	0	0
,, Dividends paid or proposed :—					,, Balance brought down	7,505	0	0
Interim, 2% paid	1,500 0 0							
Final, 3% proposed	2,250 0 0							
		3,750	0	0				
,, Balance carried forward		3,075	0	0				
		£8,825	0	0		£8,825	0	0

Note.—It is assumed that the Consolidated Profit and Loss Account, and not the above account, will be laid before the members. Otherwise the aggregate Directors' remuneration paid by the group would have to be shown, probably by the note.

, Ltd.

BALANCE SHEET, MARCH 31, 19...

Dr.		£	s.	d.	Cr.		£	s.	d.
						£ s. d.			
uthorised and Fully Paid Capital :—					*Fixed Assets :—*				
150,000 Shares of 10s. fully paid		75,000	0	0	Freehold Buildings :—				
evenue Reserves :—	£ s. d.				At cost	25,575 0 0			
General Reserve	10,500 0 0				*Less* aggregate depreciation	3,500 0 0			
Reserve against Stock Price Reduction	2,000 0 0						22,075	0	0
Profit and Loss Account	3,075 0 0				Furniture, Fixtures and Fittings :				
		15,575	0	0	At net book value on March 31, 1948, *less* sales	3,675 0 0			
taff Pension Fund		7,320	0	0	*Less* aggregate depreciation since March 31, 1948	1,530 0 0			
urrent Liabilities :—							2,145	0	0
Trade Creditors	1,410 0 0				Investment in Subsidiary Company		25,000	0	0
Expenses accrued	820 0 0								
Amount due to Subsidiary Company (B)	975 0 0						49,220	0	0
Proposed Dividend	2,250 0 0				*Investments in Quoted Securities*, at cost		10,670	0	0
		5,455	0	0	(Note Current Market Value £11,210.)				
Note.—The Investment in the Subsidiary Company consists of 100,000 fully paid ordinary shares of 5s. each in D, Ltd., being the whole of the issued ordinary capital of that company.					*Current Assets :—*				
					Stocks as valued by the directors (A)	29,060 0 0			
					Sundry Debtors and Prepayments	4,070 0 0			
					Dividend receivable from Subsidiary Company	2,500 0 0			
					Balance at Bank	7,830 0 0			
							43,460	0	0
		£103,350	0	0			£103,350	0	0

Notes. (A) It is assumed that the stock here shown includes goods purchased from D, Ltd., the invoice price of which was £10,590 and the cost price to D, .td., £8,130. D's profit on such goods, included in the trading profit of that company, was therefore £2,460.

(B) The dividend receivable is not here set off against the amount due to the subsidiary on current account. Probably it would have been.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED MARCH 31, 19..

Dr.	£	s.	d.		Cr. £	s.	d.
To Depreciation of Fixed Assets	2,770	0	0	By Trading Profit for the year	8,250	0	0
,, Managing Director's Salary	1,000	0	0				
,, Interest on Debentures	800	0	0				
,, Balance carried down	3,680	0	0				
	£8,250	0	0		£8,250	0	0
To Preference Dividend paid for the year	600	0	0	By Balance from last year	1,310	0	0
,, Proposed Ordinary Dividend 10%	2,500	0	0	,, Balance brought down	3,680	0	0
,, Balance carried forward	1,890	0	0				
	£4,990	0	0		£4,990	0	0

BALANCE SHEET, MARCH 31, 19..

Dr.	£ s. d.	£	s.	d.		£ s. d.	Cr. £	s.	d.
Issued and Fully Paid Capital :—					*Fixed Assets* :—				
10,000 6% Cumulative Preference Shares of £1 each		10,000	0	0	Plant and Machinery, at cost	46,730 0 0			
100,000 Ordinary Shares of 5s. each		25,000	0	0	*Less* aggregate depreciation	15,380 0 0			
		35,000	0	0			31,350	0	0
Revenue Reserves :—					Furniture and Fittings at cost	4,190 0 0			
General Reserve	5,000 0 0				*Less* aggregate depreciation	1,525 0 0			
Profit and Loss Account	1,890 0 0						2,665	0	0
		6,890	0	0			34,015	0	0
Debentures :—					*Current Assets* :—				
200 4% Debentures of £100 each, payable by 19.. (secured)		20,000	0	0	Stock and Work in Progress, as valued by the directors	23,520 0 0			
Current Liabilities :					Sundry Debtors and Prepayments	6,090 0 0			
Trade Creditors	3,130 0 0				Amount due from Holding Company	975 0 0			
Expenses accrued	1,760 0 0				Balance at Bank	4,680 0 0			
Proposed Dividend on Ordinary Shares	2,500 0 0								
		7,390	0	0			35,265	0	0
		£69,280	0	0			£69,280	0	0

Note.—The above Profit and Loss Account and Balance Sheet, with the auditors' report thereon, must, of course, be sent to all the members of D, Ltd., including the Preference Shareholders, and to the Debenture Holders (S. 158) These have, however, no interest in C, Ltd., and will *not* receive the Balance Sheet of that company or the group accounts.

t) the group profit shown as carried forward at the end of the previous ear (and appearing in the present accounts as brought forward from ıst year) will have been equal to the total of the separate amounts arried forward (£1,320 and £1,310 respectively, making £2,630 together), ess the adjustment of £1,950, the group profit carried forward being, herefore, £680. (2) The group trading profit for the current year will e reduced, not by the amount of the inter-company profit eliminated t the end of the year but by the amount by which the inter-company rofit at the end of the year exceeded the corresponding figure at the eginning of the year, this excess being, as stated above, £510. The ombined trading profit for the year, therefore, with which the onsolidated Profit and Loss Account commences, must be the total f the separate trading profits (£8,410 and £8,250 respectively, making 16,660 together) less this amount of £510: the figure is therefore 16,150.

If the Consolidating Schedules and Journal are kept as advised on . 531, the above adjustments will, of course, appear in them. The ntries would be as follows:—

CONSOLIDATING JOURNAL ENTRIES.

March 31, 19...

Entry no.		Dr. £	s.	d.	Cr. £	s.	d.
1	Profit and Loss Account, balance brought forward .	1,950	0	0			
	Trading Profit for current year Dr. to Stock . .	510	0	0			
					2,460	0	0

CONSOLIDATING SCHEDULE.

PROFIT AND LOSS SECTION—CREDIT SIDE.

	C, Ltd.			D, Ltd.			Adjustments.					Total.		
	£	s.	d.	£	s.	d.			£	s.	d.	£	s.	d.
Trading Profit	8,410	0	0	8,250	0	0	(1)	Dr.	510	0	0	16,150	0	0
Profit from previous year .	1,320	0	0	1,310	0	0	(1)	Dr.	1,950	0	0	680	0	0

BALANCE SHEET SECTION—ASSETS SIDE.

	£	s.	d.	£	s.	d.			£	s.	d.	£	s.	d.
Stock	29,060	0	0	23,520	0	0	(1)	Cr.	2,460	0	0	50,120	0	0

In practice, the adjusting entries, being deductions in each case, would probably be entered in red ink.

We are now in a position to draw up the Consolidated Profit and Loss Account and Balance Sheet, thus:—

Illustration 3.—This illustration shows a method of setting out the position in the consolidated accounts where the equity of a subsidiary is not "wholly owned." For the sake of brevity the usual details regarding the fixed and

C, Ltd., and D, Ltd.

CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED MARCH 31, 19...

Dr.	£ s. d.	£	s.	d.	Cr.	£	s.	d.
To Depreciation of Fixed Assets		3,420	0	0	By Trading Profit for the year	16,150	0	0
,, Directors' Remuneration :—					,, Interest from Investments	400	0	0
Fees	500 0 0							
Management Salaries and Commission	3,270 0 0							
		3,770	0	0				
,, Group Contribution to Staff Pension Fund		385	0	0				
,, Interest on Subsidiary Company's Debentures		800	0	0				
,, Balance carried down		8,175	0	0				
		£16,550	0	0		£16,550	0	0
To Transfer to Reserve against Stock Price Reduction		2,000	0	0	By Balance from last year	680	0	0
,, Dividends paid on Preference Shares of Subsidiary Company		600	0	0	,, Balance brought down	8,175	0	0
,, Dividends paid or proposed on the shares of C, Ltd. :—								
Interim 2% paid	1,500 0 0							
Final, 3% now proposed	2,250 0 0							
		3,750	0	0				
,, Balance carried forward (of which £1,890 is carried forward in the books of the Subsidiary Company)		2,505	0	0				
		£8,855	0	0		£8,855	0	0

Ltd., and D, Ltd.

CONSOLIDATED BALANCE SHEET, MARCH 31, 19...

R. | CR.

	£ s. d.	£	s.	d.
ued and Fully Paid Capital :—				
50,000 Shares of 10s. each		75,000	0	0
enue Reserves :—	£ s. d.			
General Reserves	15,500 0 0			
Reserve against Stock Price Reduction	2,000 0 0			
Profit and Loss Account	2,505 0 0	20,005	0	0
ff Pension Fund		7,320	0	0
entures :—				
100 4% Debentures of £100 each issued by Subsidiary Company, repayable by 19... secured		20,000	0	0
rrent Liabilities :—	£ s. d.			
Trade Creditors	4,540 0 0			
Expenses accrued	2,580 0 0			
Proposed Dividend	2,250 0 0	9,370	0	0
erests of Outside Shareholder :—				
Preference Shares in Subsidiary		10,000	0	0
		£141,695	0	0

	(a) Cost or (b) Net Book Value on March 31, 1948, less Sales. £ s. d.	Aggregate Depreciation. £ s. d.	£	s.	d.
Fixed Assets :—					
Freehold Buildings	(a) 25,575 0 0	3,500 0 0	22,075	0	0
Plant and Machinery	(a) 46,730 0 0	15,380 0 0	31,350	0	0
Furniture, Fixtures and	(a) 4,190 0 0	1,525 0 0	2,665	0	0
Fittings	(b) 3,675 0 0	1,530 0 0	2,145	0	0
	£80,170 0 0	£21,935 0 0	£58,235	0	0
Investments in Quoted Securities :—					
At cost			10,670	0	0
(*Note :* Current Market Value £11,210.)					
Current Assets :—		£ s. d.			
Stocks and Work in Progress as valued by the Directors		50,120 0 0			
Sundry Debtors and Prepayments		10,160 0 0			
Bank Balances		12,510 0 0	72,790	0	0
			£141,695	0	0

now be familiar as to the manner in which these are dealt with, and to repeat them in every illustration would be a waste of space. It is also assumed that the companies do not trade with each other, so that the stock adjustment dealt with in *Illustration* 2 does not arise, and that the shares in the subsidiaries have in each case been held ever since their respective dates of incorporation.

E, Ltd., is the holding company, and F, Ltd., and G, Ltd., its subsidiaries. F, Ltd., has an issued capital of £200,000, all in fully paid Ordinary Shares of £1 each, of which E, Ltd., holds 150,000, and G, Ltd., an issued capital of £100,000, all in fully paid Ordinary Shares of £1 each, of which E, Ltd., holds 90,000.

It will be seen that E, Ltd., holds 75% of the equity of F, Ltd., and 90% of the equity of G, Ltd.: thus shareholders outside the group own the remaining 25% of the equity of F, Ltd., and 10% of the equity of G, Ltd., and these shareholders must receive the separate statutory accounts of these two companies, but they are not, of course, entitled to receive the group accounts.

In order at this stage to introduce a further slight complication, it is assumed that the shares of F, Ltd., were issued at a price of 22*s.* 0*d.* per £1 share, the Share Premium Account still standing in F, Ltd.'s Balance Sheet, while the shares of G, Ltd., were issued at par. Thus E, Ltd.'s holding of 150,000 shares in F, Ltd., cost £165,000.

The separate (abbreviated) Profit and Loss Accounts of the three companies for the year ended December 31, 19..., and Balance Sheets as on that date are taken as being as on pp. 546–547, the figures being set out for convenience in columnar form.

The figures of inter-company indebtedness, required to be disclosed as aggregates in the respective Balance Sheets in accordance with the Eighth Schedule, paras. 15 (2) and 16 (1), are assumed to be:—

	£
Owing by E, Ltd., to G, Ltd.	1,680
,, F, Ltd., to E, Ltd.	10,360
,, F, Ltd., to G, Ltd.	3,970

Thus the aggregate indebtedness of F, Ltd. (to its holding company and fellow-subsidiary), is £14,330, and the aggregate amount due to G, Ltd. (by its holding company and fellow-subsidiary), is £5,650; these amounts are separately stated in the respective Balance Sheets of F, Ltd., and G, Ltd.

In preparing the Consolidated Balance Sheet, it might at first sight seem that the obvious thing to do, as regards F, Ltd., for instance, would be to split its Balance Sheet into proportionate parts. One part, which would deal with the interest of E, Ltd., alone, would show three quarters of each asset, reserve, and liability, while the other part would show the interest of the minority shareholders, the first part being used only in the construction of the Consolidated Balance Sheet. There are, however, theoretical objections to this, as well as the practical one that the inter-company indebtedness would fail to cancel out. The usual course is to consolidate the whole of the assets and liabilities and, as regards the capital and the reserves in which the minority shareholders have an interest, to set these out as a separate item or items (as may seem most informative in the particular case) disclosing the value of the minority interests. As regards the Share Premium Account, for instance, which stands in the books of F, Ltd., it is clear that 75% of this must be treated as forming part of the equity of the group, and the remaining 25% as part of the equity of the

Ltd., F, Ltd., and G, Ltd.

PARATE PROFIT AND LOSS (APPROPRIATION) ACCOUNTS FOR THE YEAR ENDED DECEMBER 31, 19...

R.

	E, Ltd. £	s.	d.	F, Ltd. £	s.	d.	G, Ltd. £	s.	d.
Balance of Loss from last year (G, Ltd.)							500	0	0
Taxation	8,100	0	0	9,300	0	0	1,000	0	0
Transfer to General Reserve .	2,000	0	0						
Dividends (G, Ltd., Nil) . .	22,500	0	0	10,000	0	0			
Balances carried forward .	4,580	0	0	6,200	0	0	1,600	0	0
	£37,180	0	0	£25,500	0	0	£3,100	0	0

Cr.

	E, Ltd. £	s.	d.	F, Ltd. £	s.	d.	G, Ltd. £	s.	d.
By Balances from last year .	2,070	0	0	5,100	0	0			
,, Net Profits for the current year	35,110*	0	0	20,400	0	0	3,100	0	0
	£37,180	0	0	£25,500	0	0	£3,100	0	0

Note.—The dividends are treated as having been actually paid: if this was not so the dividend receivable from F, Ltd., would appear in the separate balance
t of E, Ltd., as £7,500 compared with £10,000 representing the dividend payable, which would appear in the separate Balance Sheet of F, Ltd.

* Of this £7,500 represents the dividend from F, Ltd. (which would in practice have to be shown) probably "above the line," so that only the balance of £27,610
esents trading profit for consolidation.

E, Ltd., F, Ltd., and G, Ltd.

SEPARATE BALANCE SHEETS OF E, LTD., F, LTD., AND G, LTD., AS ON DECEMBER 31, 19...

(OMITTING DETAILS INESSENTIAL FOR THIS ILLUSTRATION.)

DR.

	E, Ltd. £	s.	d.	F, Ltd. £	s.	d.	G, Ltd. £	s.	d.
Issued and Fully Paid Capital:—									
E, Ltd., 250,000 shares of £1 each	250,000	0	0						
F, Ltd., 200,000 Shares of £1 each				200,000	0	0			
G, Ltd., 100,000 Shares of £1 each							100,000	0	0
Capital Reserves:—									
Share Premium Account				20,000	0	0			
Revenue Reserves:—									
General Reserve	35,000	0	0	20,000	0	0			
Reserve for Future Taxation	7,500	0	0	8,000	0	0	1,000	0	0
Profit and Loss Account	4,580	0	0	6,200	0	0	1,600	0	0
Current Liabilities:—									
Amount due to Subsidiary	1,680	0	0						
Amounts due to Holding Company and Fellow-Subsidiary				14,330	0	0			
Other Items (detailed)	3,040	0	0	4,310	0	0	1,930	0	0
	£301,800	0	0	£272,840	0	0	£104,530	0	0

CR.

	E, Ltd. £	s.	d.	F, Ltd. £	s.	d.	G, Ltd. £	s.	d.
Fixed Assets (detailed)	17,000	0	0	208,000	0	0	73,000	0	0
Shares in Subsidiary Companies, at cost:—									
150,000 Shares of F, Ltd.	165,000	0	0						
90,000 Shares of G, Ltd.	90,000	0	0						
Current Assets:—									
Amount due from Subsidiary	10,360	0	0						
Amounts due from Holding Company and Fellow Subsidiary							5,650	0	0
Other Items (detailed)	19,440	0	0	64,840	0	0	25,880	0	0
	£301,800	0	0	£272,840	0	0	£104,530	0	0

tside shareholders of F, Ltd. As regards the revenue reserves, ecisely the same principle applies, but since more than one set of tside shareholders is here involved, more than one adjustment is cessary. The adjustments are very simply made in the Consolidating hedules, which it is hardly necessary to set out here, the Journal tries being as follows:—

try no.		Dr. £	s.	d.	Cr. £	s.	d.
1	Share Premium Account . . . . . . Dr.	5,000	0	0			
	To Minority Interest (Capital Reserve, Share Premium)				5,000	0	0
	Interest of minority shareholders of F, Ltd., transferred, 25%.						
2	General Reserves . . . . Dr.	5,000	0	0			
	To Minority Interest (General Reserve) . . .				5,000	0	0
	Interest of minority shareholders of F, Ltd., transferred, 25% of £20,000.						
3	Reserves for Future Taxation . . . . . Dr.	2,100	0	0			
	To Minority Interest (Reserves for future Taxation)				2,100	0	0
	£ s. d. F, Ltd., 25% of £8,000 . . . . . 2,000 0 0 G, Ltd., 10% of £1,000 . . . . . 100 0 0 £2,100 0 0						
4	Profit and Loss Account . . . . . . Dr.	1,710	0	0			
	To Minority Interests				1,710	0	0
	£ s. d. F, Ltd., 25% of £6,200 . . . . . 1,550 0 0 G, Ltd., 10% of £1,600 . . . . . 160 0 0 £1,710 0 0						

The apportionments of the taxation provisions and dividends in e Profit and Loss Account are made in a similar manner.

We are now in a position to proceed with the preparation of the nsolidated accounts.

The make-up of the figures in the Consolidated Profit and Loss ccount is set out in detail below the account itself. As regards the alance Sheet, the aggregate of each class of assets is simply the total the corresponding classes of assets held by each separate company, id similarly as regards the current liabilities. The several items under e heading of Revenue Reserves are arrived at by deducting from the tal of the amounts in the separate Balance Sheets the proportions tributable to the minority, or "outside" shareholders, as detailed Journal entries 2, 3, and 4 above, and these interests are set out in e form of aggregates under a separate heading, described here as interests of Outside Shareholders in Subsidiary Companies." This eatment is appropriate here, since all the outside shareholders are terested in the "equity" of the respective companies in which they old shares. If there were any Preference Shares issued by F, Ltd., G, Ltd., held by outside shareholders, they would not be interested in the equities, and such shares would be shown as set out in *llustration 2.*

It remains to consider what has happened to the share premium on e shares issued by F, Ltd. 25% of this premium has been paid by e outside shareholders, and is accordingly shown as a capital reserve

E, Ltd., and Its Subsidiaries.

CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£ s. d.	£	s.	d.	Cr.	£ s. d.	£	s.	d.
To Taxation on the Group's Profits (Note (4))		15,975	0	0	By Balance from last year (*Note* (1))		5,445	0	0
,, Transfer to General Reserve		2,000	0	0	,, Net Profit for the current year (*Note* (2))	51,110 0 0			
,, Dividend paid, 9%		22,500	0	0	*Less* Profits of Subsidiary Companies attributable to outside shareholders (*Note* (3))	5,410 0 0	45,700	0	0
,, Balance carried forward:									
In the books of E, Ltd.	4,580 0 0								
In the books of the Subsidiary Companies (*Note* (5))	6,090 0 0	10,670	0	0					
		£51,145	0	0			£51,145	0	0

Notes (for the information of the reader only, *i.e.* not appended to the accounts as forwarded to the members or laid before the annual general meeting):—

	£	s.	d.
(1) E, Ltd.	2,070	0	0
F, Ltd., 75% of £5,100	3,825	0	0
	5,895	0	0
Less G, Ltd., 90% of £500	450	0	0
	£5,445	0	0

(2) E, Ltd.	27,610	0	0
F, Ltd.	20,400	0	0
G, Ltd.	3,100	0	0
	£51,110	0	0

	£	s.	d.
(3) F, Ltd., 25% of £20,400	5,100	0	0
G, Ltd., 10% of £3,100	310	0	0
	£5,410	0	0

(4) E, Ltd.	8,100	0	0
F, Ltd., 75% of £9,300	6,975	0	0
G, Ltd., 90% of £1,000	900	0	0
	£15,975	0	0

(5) F, Ltd., 75% of £6,200	4,650	0	0
G, Ltd., 90% of £1,600	1,440	0	0
	£6,090	0	0

, Ltd., and Its Subsidiaries.

CONSOLIDATED BALANCE SHEET, DECEMBER 31, 19...

Dr.	£	s.	d.	£	s.	d.	Cr.	£	s.	d.
***ssued and Fully Paid Capital of E, Ltd.* :—**							*Fixed Assets* (detailed)	298,000	0	0
250,000 Shares of £1 each				250,000	0	0	*Current Assets* (detailed)	110,160	0	0
***evenue Reserves* :—**	£	s.	d.							
General Reserves	50,000	0	0							
Reserves for Future Taxation	14,400	0	0							
Profit and Loss Account	10,670	0	0							
				75,070	0	0				
***urrent Liabilities* :—**										
Items detailed under appropriate headings				9,280	0	0				
***nterests of Outside Shareholders in Subsidiary Companies* :—**										
Issued Share Capital	60,000	0	0							
Capital Reserves	5,000	0	0							
Revenue Reserves	8,810	0	0							
				73,810	0	0				
				£408,160	0	0		£408,160	0	0

e 75% paid by E, Ltd., since the premium was in the first place eceived by F, Ltd., it was at first in the form of cash inside the group, nd since the premium is still on the books of F, Ltd., it must be epresented by assets held by F, Ltd., in some shape or form. It is ear therefore that, so far as E, Ltd., is concerned the amount of 22*s.* 0*d.* er share paid for the shares in F, Ltd., was, and still is, represented by ngible assets inside the group. From the point of view of the group s a whole, therefore, the payment of each 22*s.* 0*d.* represented merely e acquisition of 22*s.* 0*d.* worth of assets, and there is no premium. the Consolidated Balance Sheet the premium, so far as it relates to e "group," entirely disappears. The entry in the Consolidating urnal (in which the £5,000 relating to the outside shareholders has ready been dealt with in entry No. 1) would be:—

		Dr.	Cr.
		£	£
F, Ltd., Share Capital	Dr.	150,000	
F, Ltd., Share Premium		15,000	
To E, Ltd., Shares in F, Ltd. . . .			165,000

It will be seen that this eliminates the last two accounts completely.

It is of the utmost importance to appreciate the reason for the mination which takes place in this particular case. It is, as stated ove, that the net assets acquired by the group, in exchange for the ice paid, are equal in value to the price paid. From a "group" int of view, the fact that the payment was for shares is immaterial: at has been acquired is assets which belong to the group. In actice, this will rarely be the case, and (almost) never when shares e acquired in a subsidiary which was already in existence and carrying business before the date of acquisition of the shares. In such a case e price paid for the shares will hardly ever be exactly equal to the ok value of the tangible assets owned by the subsidiary at the date acquisition. There will either be an apparent surplus or a deficiency, cording to circumstances, and this case will be considered in the next ustration.

Illustration 4.—H, Ltd., whose Balance Sheet on June 30, 19..., was as set ut on p. 553, proceeds on the following day to acquire the whole of the ordinary hares of K, Ltd., whose Balance Sheet was as set out on p. 553. The price aid for the shares was £64,000, and in the subsequent separate Balance Sheet f H, Ltd. (which we need not set out), this will appear as the cost of "Investment in Subsidiary Company."

The Consolidated Balance Sheet immediately after the acquisition uld be as shown on p. 553, and there are two points in this which uire explanation:—

(1) The (book) value of the equity of K, Ltd., which is also equal he (book) value of the net assets acquired by the group in exchange cash, is:—

	£
res in K, Ltd., at par	40,000
enue Reserves (the preference Shareholders of K, Ltd., have no terest in these)	13,300
	£53,300

The calculation of this figure from a "net asset" point of view ould be:—

	£
Gross Assets of K, Ltd.	106,700
Less, Current Liabilities	3,400
Net Assets	103,300
Less, Interest of Preference Shareholders of K, Ltd. .	50,000
	£53,300

The price paid to acquire these net assets was £64,000, which is 10,700 in excess of their book value. It follows that on consolidation iis amount of £10,700 remains as a debit balance. It may properly e described as Goodwill, or, alternatively and more accurately, as Excess of Cost of Acquisition of Subsidiary over Book Value of ssets" or some equivalent expression.

It should be noted also that the Revenue Reserves of K, Ltd., annot appear as such in the Group Balance Sheet. Quite irrespective f the cost of the shares, the revenue reserves have arisen from past rading, *i.e.* before the date of acquisition by H, Ltd. From the point f view of H, Ltd., therefore, that is from the point of view of the roup as such, they represent profits earned while K, Ltd., was not a nember of the group. They are therefore capital profits, and while hey could quite properly be distributed as dividend at *any* time by ., Ltd., to its members (*i.e.* now to H, Ltd.), H, Ltd., could not roperly in turn pass them on to its own members: that would amount o a distribution out of capital. If K, Ltd., were in fact to pay to I, Ltd., a dividend out of such past profits, the dividend would from he point of view of H, Ltd., amount to a reduction of the purchase rice paid for the shares, and would most properly be treated in the ooks of H, Ltd., as such, being credited to the Investment Account. lternatively, H, Ltd., could credit it to a Capital Reserve, but a apital Reserve opened in this way would really be a set off against he Investment Account, being in actual fact related to it and representing a partial realisation of it. In the group accounts, if this ias been done, the Capital Reserve would in any case be deducted rom the "Excess of Cost of Acquisition."

(2) The second point relates to the manner of setting out the fixed ssets of K, Ltd., in the Consolidated Balance Sheet. The separate Balance Sheet of K, Ltd., discloses the figure of cost, £109,000, but from the point of view of the group this figure is meaningless. The relevant fact is that at the date K, Ltd., became a member of the group, that is to say the date on which the group acquired an interest in the assets, the book value of the assets was £67,400, and *prima facie* this is the cost of the fixed assets to the group, and is the figure to be included in the total cost of the group's fixed assets. Any other treatment would depend on questions of fact. It might be, for instance, that before acquiring the shares of K, Ltd., the directors of H, Ltd., had a valuation made of the fixed assets, and that according

	£ s. d.	£	s.	d.		£ s. d.	£	s.	d.
Issued and Fully Paid Capital :—					*Fixed Assets* (detailed) at cost	158,000 0 0			
200,000 Shares of £1 each		200,000	0	0	*Less* aggregate depreciation	52,000 0 0	106,000	0	0
Revenue Reserves :—					*Current Assets* :—				
General Reserve	50,000 0 0				Balance at Bank	70,000 0 0			
Profit and Loss Account	11,700 0 0	61,700	0	0	Other Assets (detailed)	93,200 0 0	163,200	0	0
Current Liabilities (detailed)		7,500	0	0					
		£269,200	0	0			£269,200	0	0

Dr. **K, Ltd.**

BALANCE SHEET, JUNE 30, 19...

Cr.

	£ s. d.	£	s.	d.		£ s. d.	£	s.	d.
Issued and Fully Paid Capital :—					*Fixed Assets* (detailed) at cost	109,000 0 0			
500,000 6% Cumulative Preference Shares of £1 each	50,000 0 0				*Less* aggregate depreciation	41,600 0 0	67,400	0	0
40,000 Ordinary Shares of £1 each	40,000 0 0	90,000	0	0	*Current Assets* :—				
Revenue Reserves :—					Balance at Bank	1,200 0 0			
General Reserve	10,000 0 0				Other Assets (detailed)	38,100 0 0	39,300	0	0
Profit and Loss Account	3,300 0 0	13,300	0	0					
Current Liabilities (detailed)		3,400	0	0					
		£106,700	0	0			£106,700	0	0

H, Ltd., and its Subsidiary K, Ltd.

Dr.

CONSOLIDATED BALANCE SHEET, JULY 1, 19...

Cr.

	£ s. d.	£	s.	d.		£ s. d.	£	s.	d.
Issued and Fully Paid Capital of H, Ltd. :—					*Fixed Assets* (detailed) :—				
200,000 Shares of £1 each		200,000	0	0	At cost	225,400 0 0			
Revenue Reserves :—					*Less* aggregate depreciation	52,000 0 0	173,400	0	0
General Reserve	50,000 0 0				*Excess of Cost of Acquisition of Subsidiary K, Ltd.*, over book value of net Tangible Assets acquired		10,700	0	0
Profit and Loss Account	11,700 0 0	61,700	0	0	*Current Assets* :—				
Issued Capital of Subsidiary K, Ltd. :—					Balance at Bank	7,200 0 0			
50,000 6% Cumulative Preference Shares of £1 each		50,000	0	0	Other Assets (detailed)	131,300 0 0	138,500	0	0
Current Liabilities (detailed)		10,900	0	0					

this valuation they were worth £80,000, or £12,600 in excess of the ook value. This difference is greater than the "Excess of Cost of cquisition of Subsidiary" (£10,700), and would seem to justify the irectors in treating that item as part of the cost of the fixed assets of , Ltd., which would then appear in the Consolidated Balance Sheet t £78,100, or £1,900 less than the valuation. This is perhaps a little ebatable, and the writer would hesitate to be dogmatic on the point; ut it is certainly arguable that it could be one of the "adjustments" ermitted by the Eighth Schedule, para. 17.

The converse of the above situation arises when the price paid for he shares in the subsidiary is less than the equity, or the book value f the net tangible assets acquired. In such a case, a credit balance ppears on consolidation, as a very little thought will show: this is learly of a capital nature and can, according to circumstances, either ppear in the Consolidated Balance Sheet as a Capital Reserve or be sed to write down any of the assets of the subsidiary which may be onsidered to have been over-valued in the books of the subsidiary at he date of acquisition.

Illustration 5.—L, Ltd., and M, Ltd., whose respective Balance Sheets as on December 31, 19..., are set out on p. 555, both prepare accounts annually to December 31. L, Ltd., has acquired the whole of the shares of M, Ltd., on June 30 immediately preceding, at a cost of £39,000, and the net profit of M, Ltd., for the year was £4,400 out of which it had paid a dividend of 5% immediately before the acquisition of its shares by L, Ltd.

Here the question of the apportionment of the profits of M, Ltd., s between the periods before and after its acquisition by L, Ltd., has o be dealt with, the former being (as we have seen in *Illustration* 4) apital from the point of view of L, Ltd. The apportionment is made n whatever basis seems best, having regard to the facts of the situation: ve will assume a time basis is considered appropriate, without any djustments. Since L, Ltd., owned the shares for six months, one half f the year's profit, or £2,200, is a revenue profit from the point of iew of L, Ltd.

The equity of M, Ltd., at the current December 31 is £30,000 plus he reserves £2,700 and £9,200 (including the undistributed profit for he year just ended), making £41,900 in all. At the date of acquisition t must have been £2,200 less, this being the amount of profit considered to have accrued during the six months (the previous payment of a ividend does not affect this), and was therefore £39,700. It appears therefore that net assets standing in the books of M, Ltd., at £39,700 were bought by the group for £39,000. There was therefore a capital profit on the transaction of £700, and this appears among the capital reserves in the Consolidated Balance Sheet.

The above would need some qualification if the capital reserve of M, Ltd., was a "statutory" item such as Share Premium Account or Capital Redemption Reserve Fund, or earmarked for a special purpose, such as a Debenture Redemption Reserve. In any of these events it would have to retain its separate identity in the Consolidated Balance Sheet. and it would not be permissible to write off against it the excess

	£ s. d.	£	s.	d.		£ s. d.	£	s.	d.
Issued and Fully Paid Capital :—					*Fixed Assets* (detailed) at cost	108,000 0 0			
100,000 Shares of £1 each		100,000	0	0	*Less* aggregate depreciation	32,700 0 0	75,300	0	0
Revenue Reserves :—					*Investment in Subsidiary Company :—*				
General Reserve	15,000 0 0				30,000 Fully Paid Shares of L, Ltd., at cost		39,000	0	0
Profit and Loss Account	6,700 0 0	21,700	0	0	*Current Assets* (detailed)		21,300	0	0
Current Liabilities (detailed)		13,900	0	0					
		£135,600	0	0			£135,600	0	0

M, Ltd.

BALANCE SHEET, DECEMBER 31, 19...

Dr. Cr.

	£ s. d.	£	s.	d.		£ s. d.	£	s.	d.
Issued and Fully Paid Capital :—					*Fixed Assets* (detailed) at cost	36,300 0 0			
30,000 Shares of £1 each		30,000	0	0	*Less* aggregate depreciation	16,200 0 0	20,100	0	0
Capital Reserve		2,700	0	0	*Current Assets* (detailed)		23,450	0	0
Revenue Reserves :—									
General Reserve	5,500 0 0								
Profit and Loss Account	3,700 0 0	9,200	0	0					
Current Liabilities (detailed)		1,650	0	0					
		£43,550	0	0			£43,550	0	0

L, Ltd., and M, Ltd.

CONSOLIDATED BALANCE SHEET, DECEMBER 31, 19...

Dr. Cr.

	£ s. d.	£	s.	d.		£ s. d.	£	s.	d.
Issued and Fully Paid Capital of L, Ltd. :—					*Fixed Assets* (detailed) :—				
100,000 Shares of £1 each		£100,000	0	0	At cost	129,250 0 0			
Capital Reserve		700	0	0	*Less* aggregate depreciation	33,850 0 0	95,400	0	0
Revenue Reserves :—					*Current Assets* (detailed)		44,750	0	0
General Reserve	15,000 0 0								
Profit and Loss Account	8,900 0 0	23,900	0	0					
Current Liabilities (detailed)		15,550	0	0					
		£140,150	0	0			£140,150	0	0

cost of acquisition of the shares of M, Ltd. Only the "capitalised" revenue reserves, £7,000, would be available for that purpose, leaving £2,000 still to appear in the Consolidated Balance Sheet as the "Excess of Cost of Acquisition." In the solution given on p. 555 it is assumed that this is not the case, the whole of the capital reserve being available to set off.

One further point remains to be considered: the "cost" and "aggregate depreciation" of the fixed assets as shown in the Consolidated Balance Sheet. The same considerations apply as in *Illustration* 4, but here we have the additional complication that a portion of the "aggregate depreciation" shown in the separate Balance Sheet of M, Ltd., will relate to the six months since acquisition. It is simply a question of ascertaining the facts and analysing the figures accordingly. For the present purpose we will assume, as a fact, that there have been no additions to, or sales of fixed assets by M, Ltd., during the past year, and the total depreciation provided in respect of the year (included, of course, in the aggregate shown) was £2,300. The cost of fixed assets in the Consolidated Balance Sheet is then made up of (L, Ltd.) £108,000, and (M, Ltd.) £21,250, while the aggregate depreciation is the total of (L, Ltd.) £32,700 and (M, Ltd.) £1,150.

Needless to say, it is not only in the year of acquisition of a new subsidiary that the above adjustments have to be made: the same considerations will apply year by year afterwards. Once a portion of a subsidiary's revenue reserves are capitalised for grouping purposes the same must be done each year afterwards so long as that subsidiary remains a subsidiary; however, the figure once ascertained for that subsidiary is ascertained for good: it is merely a matter of making the same adjustment in each future year.

As regards the cost and aggregate depreciation of assets, the same would apply so long as the same assets were held, but since most assets are used up and written off sooner or later, the adjustment will, on the whole, tend to decrease year by year, needing fresh calculation from time to time, and when the fixed assets held by a subsidiary have all disappeared the need to make this particular adjustment will have disappeared too.

In practice, tricky problems in connection with the apportionment of reserves between revenue and capital can arise, especially where a company starts by acquiring a minority holding in another and increases its interest by periodical purchases till at last (perhaps after a considerable number of years) it acquires more than half the equity and now (for the first time) has a subsidiary. Group accounts are now prepared for the first time, but it can be seen that the correct treatment of reserves in such accounts can be settled only after a careful analysis of the reserves over all years, since shares were first acquired in the company that has now become a subsidiary. However, it is hardly within the scope of this chapter to go farther into this branch of the subject, and we will leave it at that.

Losses of Subsidiaries.—These fall into two categories, losses before acquisition and losses after acquisition.

Losses before acquisition will naturally have been taken into account at the time of acquisition, and will be reflected in the price paid for the shares, which will be related to the net book value of the assets of the subsidiary rather than the nominal amount of shares acquired. Thus a company may be willing to buy, perhaps in order to secure a name or goodwill, the whole share capital of a company which has failed and lost practically the whole of its assets, or which has for some other reason ceased to trade, and in such a case the nominal value of shares acquired may be many times the price paid. In preparing consolidated accounts no particular difficulty arises from this fact. The pre-acquisition losses in the subsidiary books are, of course, capital losses from the point of view of the group, and in the Consolidated Balance Sheet it is only the excess of the purchase price (if any) over the net assets of the subsidiary that appears as " Goodwill," " Cost of Control," or " Excess Cost of Acquisition of Subsidiary," etc. If profits are subsequently made by the subsidiary the holding company must decide whether to use them to write off the old losses of the subsidiary, or (as it would have to if it wished to receive dividends from the subsidiary) to reduce the capital of the subsidiary and get rid of the past losses in that manner. Neither course gives rise to any difficulty on consolidation, but the consolidated accounts must, of course, be drawn up in such a way as to disclose clearly what has been done.

Losses after acquisition are quite another matter. They are losses of the group, and must be dealt with as such, though there is nothing to compel the disclosure in the consolidated accounts of the fact that a particular subsidiary has made a loss or the amount of that loss. There is nothing to prevent a holding company transferring the loss of a subsidiary to its own books; this is sometimes done, but only, of course, where the subsidiary is wholly owned—if there are outside shareholders such a course would amount to making a present to them. If there are no outside shareholders the transfer amounts to little more than a book-keeping entry, involving no transfer of equity from one individual to another. If such transfer is not made, the loss is carried forward in the books of the subsidiary concerned, and the consolidated accounts must be drafted in such a way as to indicate the fact.

Illustration 6.—In this illustration we will take the case of a holding company, N, Ltd., which has three subsidiaries, O, Ltd., P, Ltd., and Q, Ltd., none of which are wholly owned. All the shares now held in each subsidiary have been owned by N, Ltd., for more than a year; at the time of acquisition O, Ltd., had made profits and had a credit balance standing on its Profit and Loss Account, but has made a loss in the current year. P, Ltd., had made a loss prior to acquisition, but has made profits since, including the current year. Q, Ltd., is a foreign subsidiary, not to be consolidated, which has made a loss.

The separate Profit and Loss Accounts and Balance Sheets of N, Ltd., O, Ltd., and P, Ltd., are set out on pp. 558–559. The accounts of Q, Ltd., are not shown, since, as they are not consolidated, we are not concerned with them beyond the statutory particulars which have to be stated regarding total directors' remuneration and the information required to be disclosed by the Eighth Schedule, para. 15 (2), (3), and

, Ltd., O, Ltd., and P, Ltd.

SEPARATE PROFIT AND LOSS ACCOUNTS FOR THE YEAR ENDED DECEMBER 31, 19...

(APPROPRIATION SECTION ONLY.)

DR.

	N, Ltd.			O, Ltd.			P, Ltd.		
	£	s.	d.	£	s.	d.	£	s.	d.
To Balance of Loss brought from last year (P, Ltd.)	–	–	–	–	–	–	2,700	0	0
,, Net Loss for current year (O, Ltd.)	–	–	–	1,100	0	0	–	–	–
,, Proposed Dividend (N, Ltd., 5%)	5,000	0	0	–	–	–	–	–	–
,, Balances carried forward (N, Ltd., and P, Ltd.)	3,200	0	0	–	–	–	400	0	0
	£8,200	0	0	£1,100	0	0	£3,100	0	0

CR.

	N, Ltd.			O, Ltd.			P, Ltd.		
	£	s.	d.	£	s.	d.	£	s.	d.
By Balance brought forward from last year (N, Ltd., and O, Ltd.)	2,100	0	0	300	0	0	–	–	–
,, Net Profit for the current year (N, Ltd., and P, Ltd.)	6,100	0	0	–	–	–	3,100	–	–
,, Balance of Loss carried forward (O, Ltd.)	–	–	–	800	0	0	–	–	–
	£8,200	0	0	£1,100	0	0	£3,100	0	0

Notes: (A) At the date it became a subsidiary of N, Ltd., O, Ltd., had a credit balance of £1,500 on its Profit and Loss Account and no reserves.
(B) At the date it became a subsidiary of N, Ltd., P, Ltd., had a debit balance of £12,000 on its Profit and Loss Account.

N, Ltd., O, Ltd., and P, Ltd.

SEPARATE BALANCE SHEETS, DECEMBER 31, 19...

Dr.

	N, Ltd. £	s.	d.	O, Ltd. £	s.	d.	P, Ltd. £	s.	d.
Issued and Fully Paid Capital :—									
N, Ltd., 100,000 Shares of £1 each	100,000	0	0	–	–	–	–	–	–
O, Ltd., 50,000 Shares of £1 each	–	–	–	50,000	0	0	–	–	–
P, Ltd., 30,000 Shares of £1 each	–	–	–	–	–	–	30,000	0	0
Revenue Reserves :—									
General Reserve (N, Ltd., only) .	10,000	0	0	–	–	–	–	–	–
Profit and Loss Accounts . .	3,200	0	0	–	–	–	400	0	0
Current Liabilities :—									
Proposed Dividend (N, Ltd., only)	5,000	0	0	–	–	–	–	–	–
Amounts due to Holding Company	–	–	–	3,700	0	0	600	0	0
Other Items (detailed as necessary)	8,300	0	0	2,200	0	0	1,800	0	0
	£126,500	0	0	£55,900	0	0	£32,800	0	0

Cr.

	£ s. d.	N, Ltd. £	s.	d.	O, Ltd. £	s.	d.	P, Ltd. £	s.	d.
Fixed Assets (detailed) :—										
At cost		45,700	0	0	50,800	0	0	23,500	0	0
Less aggregate depreciation (Note C)		32,300	0	0	18,200	0	0	5,800	0	0
		£13,400	0	0	£32,600	0	0	£17,700	0	0
Investments in Subsidiary Companies at Cost :—										
45,000 Shares in O, Ltd. . . .	52,600 0 0									
22,500 Shares in P, Ltd. . . .	14,200 0 0									
25,000 Shares in Q, Ltd. (Note D) .	15,700 0 0									
		82,500	0	0						
Current Assets :—										
Amounts due by Subsidiary Companies (Note E) . . .		12,400	0	0	–	–	–	–	–	–
Other Items (detailed) . .		18,200	0	0	22,500	0	0	15,100	0	0
Profit and Loss Account :—										
Debit Balance		–	–	–	800	0	0	–	–	–
		£126,500	0	0	£55,900	0	0	£32,800	0	0

Notes : (C) The depreciation provided by the subsidiaries, before their respective dates of acquisition by N, Ltd., was : O, Ltd., £8,300, P, Ltd., £1,900.
(D) The Total issued share capital of Q, Ltd., is £40,000 in fully paid shares of £1 each.
(E) Made up of O, Ltd., £3,700, P, Ltd., £600 and Q, Ltd., £8,100.

(4) (see p. 531). Where a subsidiary is not dealt with in the group accounts this information in regard to that subsidiary must be given in the group accounts, just as though the group accounts were the accounts of a holding company which is not preparing group accounts (para. 21).

The Consolidating Journal entries and Schedules are set out below and on p. 561, and the Consolidated Profit and Loss Account and Balance Sheet on p. 562.

N, Ltd., and Consolidated Subsidiaries.

CONSOLIDATING JOURNAL ENTRIES DECEMBER 31, 19...

Entry No.			£	s.	d.	£	s.	d.
1	Outside Interests . . . . Dr.		645	0	0			
	To Profit and Loss Account (old)					645	0	0
		£ s. d.						
	P, Ltd., Loss 25% of £2,700 . .	675 0 0						
	O, Ltd., Profit 10% of £300 . .	30 0 0						
	Aggregate Loss	£645 0 0						
2	Profit and Loss (current year) . . . . . Dr.		665	0	0			
	To Outside Interests					665	0	0
		£ s. d.						
	P, Ltd., Profit 25% of £3,100 . .	775 0 0						
	O, Ltd., Loss 10% of £1,100 . .	110 0 0						
	Aggregate profit	£665 0 0						
3	Excess of Cost of Acquisition (O, Ltd.). . . Dr.		7,600	0	0			
	O, Ltd., Share Capital . . . . . Dr.		50,000	0	0			
	To Investment in O, Ltd.					52,600	0	0
	Outside Interests (Share Capital)					5,000	0	0
	Adjustment of share capital of O, Ltd. and cost of Investment, etc.							
4	P, Ltd., Share Capital . . . . . . Dr.		30,000	0	0			
	To Investment in P, Ltd.					14,200	0	0
	Outside Interests (Share Capital)					7,500	0	0
	Capital Reserve (P, Ltd.) (Note 1)					8,300	0	0
	Adjustment of share capital of P, Ltd. and cost of Investment, etc.							
5	Profit and Loss (Old) . . . . Dr.		1,350	0	0			
	To Capital Reserve (O, Ltd.)					1,350	0	0
	Capitalisation of 90% of balance at credit of Profit and Loss Account of O, Ltd. (£1, 500) at date of acquisition (Note 2).							
6	Capital Reserve (O, Ltd.) . . . . . . Dr.		1,350	0	0			
	To Excess of Cost of Acquisition					1,350	0	0
	Set off of the former balance (Note 2).							
7	Aggregate Depreciation . . . . . . Dr.		10,200	0	0			
	To Fixed Assets					10,200	0	0
	To adjust cost of fixed assets of subsidiaries to book value at date of acquisition, as stated							
		£ s. d.						
	O, Ltd.	8,300 0 0						
	P, Ltd.	1,900 0 0						
	(See Note 3).	£10,200 0 0						
8	Inter Company Debts (Cr.) . . . . . . Dr.		4,300	0	0			
	Amount due from Subsidiary not consolidated . Dr.		8,100	0	0			
	To Inter Company Debts (Dr.).					12,400	0	0
	To cancel out debts between the holding company and consolidated subsidiaries.							

EXPLANATORY NOTES.

1. Journal entry No. 4. At the date of acquisition this capital reserve is a set-off against the loss then standing on the books of P, Ltd. N, Ltd.'s proportion of this loss (£12,000) is £9,000, so that on setting off the capital reserve there remains a net debit of £700, which represents the actual "Excess Cost of Acquisition." At the date we are now considering, however, the loss has been entirely extinguished by subsequent profits; since this profit is not distributable as dividend it is a capital profit from the point of view of the group, and now forms the Capital Reserve in the Consolidated Balance Sheet, except as to £700, which has in effect been used to extinguish the "Excess Cost of Acquisition" of P, Ltd.

2. Journal entries 5 and 6. These should be self-explanatory. It may be remarked, however, that there is much to be said for N, Ltd., actually passing these entries through its own books at the time it buys the shares in O, Ltd., the credit being, of course, to the investment account itself. If this is done the matter of capitalising the pre-acquisition profits of O, Ltd., is dealt with once and for all, and there is no need to make any further adjustment in this connection on consolidation.

3. Journal entry 7. This entry is made on the basis that fixed assets are retained at cost in one account (though admittedly the "account" in the present case is only an entry in a schedule), while aggregate depreciation is accumulated in another account. This is most strongly recommended in all cases, as stated in Chapter III, p. 47.

N, Ltd., and Consolidated Subsidiaries.

CONSOLIDATING SCHEDULES, DECEMBER 31, 19...

PROFIT AND LOSS—CREDIT SIDE.

	N, Ltd.	O, Ltd.	P, Ltd.	Adjustments.	Total.
	£	£	£	£	£
Profit and Loss, last year	2,100	300	Dr. 2,700	1 645 5 Dr. 1,350	1,005
Profit and Loss this year	6,100	Dr. 1,100	3,100	2 Dr. 665	7,435

BALANCE SHEET—LEFT SIDE.

	N, Ltd.	O, Ltd.	P, Ltd.	Adjustments.	Total.
	£	£	£	£	£
Share Capital of Subsidiaries	—	50,000	30,000	3 Dr. 50,000 4 Dr. 30,000	Nil
Capital Reserves	—	—	—	4 8,300 5 1,350 6 Dr. 1,350	8,300
Profit and Loss (need not be shown as it is already in the profit and loss account).					
Inter-Company Debts	—	3,700	600	7 Dr. 4,300	Nil
Current Liabilities.	8,300	2,200	1,800	—	12,300
Outside Interests—Share Capital	—	—	—	3 5,000 4 7,500	12,500
Outside Interests—Profit and Loss	—	—	—	1 Dr. 645 2 665	20

BALANCE SHEET—RIGHT SIDE.

	N, Ltd.	O, Ltd.	P, Ltd.	Adjustments.	Total.
Fixed Assets, at cost	45,700	50,800	23,500	7 Cr. 10,200	109,800
Aggregate Depreciation	32,300	18,200	5,800	7 Dr. 10,200	46,100
Inter-Company Debts	12,400	—	—	8 Cr. 12,400	Nil
Excess Cost of Acquisition, O, Ltd.	—	—	—	3 7,600 6 Cr. 1,350	6,250
Amount due from Subsidiary Company not Consolidated	—	—	—	8 8,100	8,100
Current Assets	18,200	22,500	15,100	—	55,800

NSOLIDATED PROFIT AND LOSS ACCOUNT OF N, LTD., AND ITS SUBSIDIARIES DEALT WITH THEREBY (O, LTD., AND P, LTD.), FOR THE YEAR ENDED DECEMBER 31, 19...

Dr.	£	s.	d.	Cr.	£	s.	d.
Debit Balance from last year	1,005	0	0	By Net Profit for the current year, after deducting the loss of a subsidiary company so far as it concerns the group	7,435	0	0
Proposed Dividend on the shares of N, Ltd., 5%	5,000	0	0				
Balance carried forward	1,430	0	0				
	£7,435	0	0		£7,435	0	0

ALANCE SHEET OF N, LTD., AND ITS SUBSIDIARIES DEALT WITH THEREBY (O, LTD., AND P, LTD.), DECEMBER 31, 19...

Dr.	£ s. d.	£	s.	d.	Cr.	£ s. d.	£	s.	d.
ssued and Fully Paid Capital of N, Ltd. :—					*Fixed Assets* (detailed) :—				
100,000 Shares of £1 each		100,000	0	0	At cost	109,800 0 0			
apital Reserve :—					*Less* Aggregate depreciation	46,100 0 0	63,700	0	0
Profit of a Subsidiary applied in writing off losses incurred before acquisition		8,300	0	0	*Excess of Cost of Acquisition of a Subsidiary* over the book value of Net Tangible Assets acquired		6,250	0	0
evenue Reserves :—					*Investment in Subsidiary not Consolidated* :—				
General Reserve	10,000 0 0				25,000 fully paid Ordinary Shares of £1 each in Q, Ltd., at cost		15,700	0	0
Profit and Loss Account	1,430 0 0	11,430	0	0	*Current Assets* :—				
urrent Liabilities :—					Amount due by Subsidiary not Consolidated	8,100 0 0			
Proposed Dividend on Shares of N, Ltd.	5,000 0 0				Other Items (detailed as necessary)	55,800 0 0	63,900	0	0
Other Items (detailed as necessary)	12,300 0 0	17,300	0	0					
nterests of Outside Shareholders of Subsidiaries Consolidated :—									
Fully Paid Ordinary Shares	12,500 0 0								
Reserves	20 0 0	12,520	0	0					
		£149,550	0	0			£149,550	0	0

Statutory Information.—The following particulars (details are assumed) are required by the Eighth Schedule, para. 21, in relation to the non-consolidated company, Q, Ltd. These details are the same as are required by para. 15 (4) to be given by a holding company where group accounts are not submitted (note that the particulars required by para. 15 (2) and (3) are incorporated in the Consolidated Balance Sheet itself):—

(Pursuant to sub-paragraph (4) (*a*).) The reason that the subsidiary, Q, Ltd., is not consolidated in the group accounts is that this company is incorporated and trading in a foreign country, and currency restrictions and depreciation make it impossible to ascertain the position satisfactorily.

(Pursuant to sub-paragraph (4) (*b*) and (*c*).) Q, Ltd., has incurred losses since it became a member of the group, the details of which, as nearly as your directors can estimate them (taking the Ruritanian peso at 1,000,000 to the £) and so far as they concern the group, are as follows:—

For the current year	£650
For all previous years since Q, Ltd., became a member of the group	£3,200

No provision has been made in the group accounts for any of these losses.

EXAMINATION QUESTIONS.

1. A, Ltd., owns the entire capital of B, Ltd., and 90% of the capital of C, Ltd. The following are the Profit and Loss items in the trial balances at December 31, 1951, covering the year to that date:—

	A, Ltd.	B, Ltd.	C, Ltd.	Total
	£	£	£	£
Credits:—				
Sales	755,968	98,762	127,749	982,479
Sundry Income	4,831	—	—	4,831
Balance on Profit and Loss Account at December 31, 1950 . .	30,119	612	5,723	36,454
Debits:—				
Cost of Sales	522,257	66,281	79,143	667,681
Selling Expenses	136,597	17,865	26,035	180,497
Administration Expenses . .	70,540	11,951	13,846	96,337
Depreciation Provision for the Year	5,319	493	1,032	6,844
Interest on Bank Loans and Overdrafts	—	—	242	242
Interest on Debentures, gross (paid to December 31, 1951) . . .	4,000	—	—	4,000
Income Tax on Profits of the Year 1951	12,739	738	3,060	16,537
Dividends (net) Proposed for Year .	7,875	495	3,150	11,520

The holdings in the subsidiary companies were acquired on December 31, 1949, at which date the balances on their Profit and Loss Accounts were:—

		£
B, Ltd.	Loss	3,417
C, Ltd.	Profit	3,693

No dividends have been declared or paid by the subsidiary companies since the date of acquisition.

The sales of A, Ltd. include £32,842 for goods sold to B, Ltd. Some of these goods were still in stock at December 31, 1951, and it is estimated that their stock value includes an inter-company profit of £2,246 (1950—nil).

Sundry income in A, Ltd., includes £2,000 recovered in 1951 from a debt written off as bad in 1949, and £410 interest on trade investments.

The salaries of the directors of A, Ltd., for 1951 totalled £3,187 and are included in the administration expenses. No directors' fees or other emoluments are payable.

You are required to prepare a detailed consolidated Profit and Loss and Appropriation Account for the year.

Notes.—(1) Ignore taxation, except when dealing with the specific items given.
(2) The division of the group profit between the holding company and the subsidiary companies is not required to be shown.
(3) Rough workings must be submitted.

(*Institute of Chartered Accountants.*)

2. Red, Ltd., owns the entire issued capital of White, Ltd., and £9,000 of the £10,000 issued capital of Blue, Ltd. The following were the abridged trial balances on December 31, 1951 :—

	RED, LTD.	WHITE, LTD.	BLUE, LTD.	TOTAL.
	£	£	£	£
Fixed Assets (at cost) . . .	154,318	9,743	26,291	190,352
Depreciation provision . . .	90,391	5,996	9,111	105,498
	63,927	3,747	17,180	84,854
Current Assets	216,462	39,610	49,086	305,158
Shares in Subsidiaries (at cost) :—				
White, Ltd.	7,000	—	—	7,000
Blue, Ltd.	24,000	—	—	24,000
Amounts owing by subsidiaries :—				
White, Ltd.	25,371	—	—	25,371
Blue, Ltd.	20,868	—	—	20,868
	£357,628	£43,357	£66,266	£467,251
Ordinary Share Capital (Authorised and Issued)	250,000	7,500	10,000	267,500
Current Liabilities	38,162	7,480	16,744	62,386
Amounts owing to Holding Company	—	21,827	19,407	41,234
Proposed Dividends for 1951 (less tax)	15,750	—	3,150	18,900
Profit and Loss Account and General Reserve	53,716	6,550	16,965	77,231
	£357,628	£43,357	£66,266	£467,251

At the acquisition of the subsidiaries on December 31, 1949, their Balance Sheets showed the following reserves and undistributed profits :—

	WHITE, LTD.	BLUE, LTD.
	£	£
General Reserve . . .	6,000	4,000
Profit and Loss Account .	1,819	5,320

Neither White, Ltd., nor Blue, Ltd., has paid any dividend since becoming a subsidiary of Red, Ltd.

The differences on the inter-company balances arise as follows :—

(1) Payments of £3,544 on December 31, 1951, to trade creditors made by Red, Ltd., on behalf of White, Ltd., were not taken up by the latter until 1952.

(2) A remittance by Blue, Ltd., to Red, Ltd., of £1,461 on December 31, 1951, was not received by Red, Ltd., until the new year.

The stock of White, Ltd., includes goods bought from Red, Ltd., and it is estimated that their value includes an inter-company profit of £2,246.

You are required to prepare a Consolidated Balance Sheet as on December 31, 1951.

Rough workings should be submitted.

Comparative figures for the preceding financial year are not required.

(*Institute of Chartered Accountants.*)

3. Strontium, Ltd., and Barium, Ltd., both prepare accounts annually to December 31, and the issued capital of both companies is in the form of fully paid ordinary shares of £1 each.

Barium, Ltd., has issued 80,000 shares and on Janaury 1, 1950, Strontium bought 50,000 of these from existing members at the cost of £89,500 paid in cash. The net assets of Barium, Ltd., as on December 31, 1949, as disclosed by its Balance Sheet prepared subsequently, after provision for a dividend of 10% for 1949 (which was paid in April, 1950, and of which Strontium, Ltd., received £5,000) amounted to £140,000.

The following statement shows the position of the two companies as on December 31, 1950 :—

SUMMARY OF BALANCES AFTER CLOSING PROFIT AND LOSS ACCOUNTS

	STRONTIUM, LTD.		BARIUM, LTD.	
	DR.	CR.	DR.	CR.
	£	£	£	£
Share Capital	—	200,000	—	80,000
Capital Reserves	—	—	—	40,000
Revenue Reserves as on December 31, 1949	—	60,000	—	20,000
Profit for 1950	—	37,000	—	12,000
Shares in Barium, Ltd.	89,500	—	—	—
Dividend thereon for 1949	—	5,000	—	—
Fixed Assets	160,500	—	153,000	—
Current Assets	62,500	—	17,300	—
Current Liabilities	—	10,500	—	18,300
	£312,500	£312,500	£170,300	£170,300

There was no inter-company indebtedness. Neither company had paid any interim dividend, and each now proposed to pay a dividend of 10% for 1950.

You are required to draft a consolidated balance sheet.

Show any workings and ignore taxation. (*Chartered Institute of Secretaries.*)

4. Tabulated below are the Profit and Loss Accounts of Parent, Ltd., A, Ltd., and B, Ltd., for the year ended March 31, 1946 :—

	PARENT, LTD.	A, LTD.	B, LTD.
DR.	£	£	£
Brought Forward as on April 1, 1945	—	—	25,000
Directors' Fees	5,400	3,200	1,000
Contributions to Staff Pension Funds	10,000	7,000	—
Written-off Shares in B, Ltd.	3,000	—	—
Provision for Taxation	163,000	64,000	—
Transfers to Reserve	50,000	18,000	—
Proposed Dividends (net)	80,000	2,500	—
Carried Forward	35,600	69,300	—
	£347,000	£164,000	£26,000
CR.	£	£	£
Brought Forward as on April 1, 1945	30,000	40,000	—
Trading Profits	313,000	124,000	500
Proposed Dividend from A, Ltd. (gross)	4,000	—	—
Carried Forward	—	—	25,500
	£347,000	£164,000	£26,000

You are informed :—

(1) that on April 1, 1945, Parent, Ltd., acquired—

(i) 80% of the issued and paid up Ordinary Shares of A, Ltd., which has no other class of shares, and

(ii) 75% of the issued and paid up Ordinary Shares of B, Ltd.;

(2) that the issued and paid up capital of B, Ltd., includes 10,000 5% Preference Shares of £1 each, of which 6,000 have for several years been held by Parent, Ltd., and on which the dividend has been paid up to March 31, 1944.

(3) that during the year Parent, Ltd., had purchased goods for £27,000 from A, Ltd., at a profit of £8,500 to that company, and that of those purchases £15,000, which had yielded £5,000 of that profit, were included in the closing stocks of Parent, Ltd. at £14,000;

(4) that included in the Plant and Machinery Account of B, Ltd., at cost, is plant purchased during the year from Parent, Ltd. (who manufactured it) at a profit to that company of £2,000;

(5) that each company has provided for all taxation including income tax at 10*s.* in the £ on its income to March 31, 1946.

Draw up a Consolidated Profit and Loss Account for the year ended March 31, 1946. Show your detailed workings and indicate the correlative additions to and deductions from balances aggregated for inclusion in the Consolidated Balance Sheet. (*Institute of Chartered Accountants.*)

5. Tabulated below are the draft Balance Sheets of Parent, Ltd., and its subsidiaries, A, Ltd., and B, Ltd., as on March 31, 1947 :—

	PARENT, LTD.		A, LTD.		B, LTD.	
	£	£	£	£	£	£
Share Capital :—						
Authorised, Issued and Paid up—						
Ordinary Shares of £1 each		500,000		150,000		12,500
5% Cumulative Preference Shares of £1 each		—		—		20,000
4% Mortgage Debentures		550,000		50,000		—
Premium on Issue of Shares		20,000		175,000		
Creditors :—						
Parent, Ltd.	—		55,125		—	
Members for proposed Dividend (net)	—		8,250			
Others	105,000		32,000		3,000	
		105,000		95,375		3,000
Bills Payable :—						
Issued to Parent, Ltd.		—		30,000		—
Bank Overdraft		—		75,625		—
Leasehold Amortisation Fund		—		38,000		—
E.P.T. Post-war Refund :— Provisional Amount		—		9,000		—
General Reserve :—						
Brought Forward	75,000		20,000			
Added during Year	100,000		80,000			
		175,000		100,000		
Profit and Loss Account :—						
Brought Forward	120,000		24,000			
Profit for Year	45,000		141,250			
	165,000		165,250			
Proposed Dividend receivable from A, Ltd. (gross)	12,500		—			
	177,500		165,250			
Transferred to Reserve	100,000		80,000			
	77,500		85,250			
Written-off Shares in B, Ltd.	2,500					
		75,000				
Proposed Divided (net)			8,250	77,000		—
		£1,425,000		£800,000		£35,500

	PARENT, LTD.		A, LTD.		B, LTD.	
	£	£	£	£	£	£
Goodwill, at cost		90,000		175,000		
Freehold and Leasehold Properties, at cost		270,000		65,000		12,500
Plant and Machinery, at cost	460,000		70,000		12,900	
Less Depreciation	110,000		18,000		900	
		350,000		52,000		12,000
Leaseholds Amortisation Fund Policies		—		38,000		—
Investments, at cost :—						
125,000 Ordinary Shares in A, Ltd.	300,000					
12,500 Ordinary Shares in B, Ltd.	12,500					
100,000 Preference Shares in B, Ltd.	10,000					
	322,500					
Less Dividend (net) paid by B, Ltd., out of Surplus existing at date of Purchase	7,500					
	315,000					
Less Amount written-off Ordinary Shares in B, Ltd., during year	2,500					
		312,500				
80,000 Ordinary Shares in Parent, Ltd.				100,000		
£200,000 Mortgage Debentures of Parent, Ltd.				200,000		
Stocks, at cost		75,000		90,000		5,000
Debtors :—						
A, Ltd.—Current Account	55,125					
,, —For Proposed Dividend	6,875					
Others	120,000					
		182,000		80,000		3,000
Bills Receivable :—						
Accepted by A, Ltd.	30,000					
Less :—discounted	10,000					
		20,000		—		—
Balance at Bankers		125,500		—		1,000
Profit and Loss Account :—						
Credit Balance Brought Forward					10,000	
Dividend (net) paid thereout					7,500	
					2,500	
Loss for Year		—		—	4,500	2,000
		£1,425,000		£800,000		£35,500

Notes.—(1) On April 1, 1946, A, Ltd., issued to Parent, Ltd., 125,000 Ordinary Shares for £300,000 paid in cash. The cash was applied by A, Ltd., in subscribing for 80,000 shares in Parent, Ltd., at 25*s.* a share and £200,000 debentures at par.

(2) On the same date, Parent, Ltd., acquired for cash at par 12,500 Ordinary Shares in B, Ltd. A dividend of £7,500 net paid by B, Ltd., out of the surplus existing at the date of purchase was applied in writing down the cost of the investment which has been further reduced by £2,500 appropriated from profits.

(3) The stocks of Parent, Ltd., include £40,000 purchased from A, Ltd., during the year, at a profit to the latter company of £10,000.

(4) The Plant and Machinery of B, Ltd., includes plant acquired from Parent, Ltd., during the year at a profit to the latter company of £6,000.

(5) The dividend on the Preference Shares of B, Ltd., is one year in arrear.

The Directors of Parent, Ltd., propose to publish a Consolidated Balance Sheet as on March 31, 1947, and desire you :—

(*a*) to prepare detailed schedules of workings leading to items suitable for inclusion in that Balance Sheet, and

(*b*) to draft the Balance Sheet.

Calculations are to be made to the nearest pound. (*Institute of Chartered Accountants.*)

6. The following information relates to the three constituent members of a group of companies. The issued capitals of A. Ltd., and B. Ltd., and the relative holdings therein have remained unaltered since their formation some years ago. There were no pre-acquisition profits.

	Holdings Ltd.	A. Ltd.	B. Ltd.
Issued Capital:	£	£	£
Ordinary Stock	1,000,000	400,000	250,000
Cumulative Preference Stock	600,000	200,000	100,000
Rate of Preference Dividend	5%	5%	6%
Inter-company holdings:—			
Held by Holdings Ltd.:—			
Ordinary Stock	—	400,000	150,000
Cumulative Preference Stock	—	100,000	50,000
Held by A. Ltd.:—			
Ordinary Stock	—	—	50,000
Balances at March 31, 1946:—	£	£	£
Revenue Reserves	500,000	100,000	61,000
Profit and Loss Account (credit)	51,650	21,840	18,460
Year ended March 31, 1947:	£	£	£
Inter-company Dividends Received (gross)	78,000	10,000	—
Interest on British Government Securities (gross)	25,000	8,000	2,000
Trading Profit (subject to Depreciation and Directors' Fees, etc., shown below)	157,634	211,627	177,500
Depreciation	6,500	3,000	7,500
Directors' Fees and Remuneration	5,000	2,000	6,000
Income Tax (suffered by deduction)	46,350	8,100	900
Dividends paid (net):—			
Preference Dividend for Year	16,500	5,500	3,300
Interim Ordinary Dividend	44,000	22,000	27,500
Rate of Interim Ordinary Dividend (gross)	8%	10%	20%
Provisions are to be made for:—	£	£	£
N.D.C. and Profits Tax for Year ended March 31, 1947	9,000	6,800	11,500
Income Tax Schedule D, 1947-48	64,000	43,000	69,100
Proposed final Ordinary Dividend (subject to tax)	17%	15%	[illegible]

There is no managing director of Holdings, Ltd., and the directors of that company constitute the entire directorate of A. Ltd., and of B. Ltd.

You are required to prepare both (1) and (2) below, viz.:—

(1) Necessary working schedules leading to—

(2) Consolidated Profit and Loss Account of the group for the year ended March 31, 1947, in such a form as to show the final balance of revenue reserves and undistributed profits appearing in the Consolidated Balance Sheet as on that date. (*Institute of Chartered Accountants.*)

7. A limited company, X. Ltd., has two wholly owned subsidiaries, P. Ltd., and Q. Ltd., both acquired some years ago. Neither subsidiary has declared a dividend since acquisition.

P. Ltd., has an issued capital of £40,000, all in fully paid ordinary shares, and the cost of these shares to X. Ltd., was £24,000. At the time X. Ltd., bought the shares P, Ltd., had no reserves and there was a debit balance of £11,000 on its Profit and Loss Account. Since then P, Ltd., has made profits, and there is now a credit balance of £7,000 on its Profit and Loss Account.

Q, Ltd., has an issued capital of £50,000, all in fully paid ordinary shares, and the cost of these to X, Ltd., was £64,000. At the time of acquisition of these shares by X, Ltd., the reserves and undistributed profit of Q, Ltd., amounted to £8,000 but since acquisition Q, Ltd., has incurred losses which have reduced its reserves (including undistributed profit) to £4,000.

You are required to state :—

(*a*) how you would recommend that X, Ltd., should deal with the shares of the two subsidiaries in its books and accounts, and

(*b*) how the position would be reflected in the consolidated accounts.

(*Chartered Institute of Secretaries.*)

8. On July 1, 1945, M, Ltd., bought, at a cost of £47,500, 40,000 out of the 50,000 issued Ordinary shares of C, Ltd., and has held them continuously ever since. Both companies make up accounts annually to June 30, and the Balance Sheet of C, Ltd., drawn up as on June 30, 1945, disclosed (after providing for the final dividend for the previous year, in which M, Ltd., did not participate) a capital reserve of £4,000 and revenue reserves totalling £12,000.

The respective Balance Sheets of the two companies as on June 30, 1949, in summarised form, were as follows :—

M, LTD. BALANCE SHEET—JUNE 30, 1949.

	£		£
Issued and Fully Paid Capital		Fixed Assets . . .	83,000
100,000 Shares of £1 .	100,000	Investment in Subsidiary Company	
Revenue Reserves (including balance of Profit and Loss Account) . . .	52,500	40,000 Ordinary Shares in C, Ltd., at cost .	47,500
Current Liabilities . .	19,300	Dividend Receivable from Subsidiary Company .	2,400
		Other Current Assets . .	38,900
	£171,800		£171,800

C, LTD. BALANCE SHEET—JUNE 30, 1949.

	£		£
Issued and Fully Paid Capital		Fixed Assets . . .	62,000
20,000 Preference Shares of £1 . . .	20,000	Current Assets . . .	41,500
50,000 Ordinary Shares .	50,000		
	70,000		
Capital Reserve . . .	4,000		
Revenue Reserves (including Balance of Profit and Loss Account) . . .	18,000		
Dividend Payable on Ordinary Shares . . .	3,000		
Other Current Liabilities .	8,500		
	£103,500		£103,500

You are required to prepare a consolidated Balance Sheet as on June 30, 1949.
(*Chartered Institute of Secretaries.*)

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9. Prepare a Consolidated Profit and Loss Account for the year ended March 31, 1952, of X, Ltd., and its subsidiaries, Y, Ltd., and Z, Ltd. The Profit and Loss Accounts of each company, and supplementary information, are given below :—

	X, LTD.	Y, LTD.	Z, LTD.
	£	£	£
Trading Profits	28,000	26,000	12,000
Investment Income (gross)	120	160	240
Income from Subsidiaries (gross) :—			
Interest on Debentures—Y, Ltd.	200	—	—
Dividend Receivable—Y, Ltd.	5,400	—	—
,, ,, —Z, Ltd.	1,500	—	—
	35,220	26,160	12,240
Deduct—			
Directors' Remuneration	3,000	1,500	750
Auditors' Remuneration	500	300	200
Depreciation	5,000	3,000	2,000
Debenture Interest (gross)	—	600	—
	8,500	5,400	2,950
Balance	26,720	20,760	9,290
Deduct—			
Taxation on Profits and Income to date			
Profits Tax	3,000	3,860	1,800
Income Tax	12,000	8,000	4,690
	15,000	11,860	6,490
Net Profit for Year	11,720	8,900	2,800
Add—Balance from last year	20,000	12,000	10,000
	31,720	20,900	12,800
Deduct—			
Transfer to General Reserve	5,000	2,000	2,000
Proposed Dividends (net)	2,625	3,150	1,050
	7,625	5,150	3,050
Balance to next year	£24,095	£15,750	£9,750

The holding of X, Ltd., in Y, Ltd., comprises £27,000 ordinary stock out of a total of £30,000; and in Z, Ltd., comprises £7,500 ordinary stock out of a total of £10,000.

The balances on Profit and Loss Accounts of Y, Ltd., and Z, Ltd., when (many years ago) X, Ltd., acquired shares in those companies were

Y, Ltd.	£5,000 (credit)
Z, Ltd.	£2,000 (debit).

There were no other revenue reserves at date of acquisition, or at March 31, 1951.

Stock of Z, Ltd., at March 31, 1952, included £1,000 for goods invoiced by X, Ltd., at cost plus 25%. No provision has been made by X, Ltd., against this

Director's Remuneration comprises

Director	X, LTD.	Y, LTD.	Z, LTD.
	£	£	£
A	1,000	—	—
B	1,000	500	—
C	1,000	250	250
D	—	750	—
E	—	—	500
	£3,000	£1,500	£750

(*Incorporated Accountants.*)

10. The summarised accounts of Aye, Ltd., and its subsidiary Ess, Ltd., for the year ended December 31, 1950, were :—

	AYE, LTD.		ESS, LTD.	
Profit and Loss Accounts :—	£	£	£	£
Trading Profit		66,373		28,412
Before charging—				
Provision for Depreciation	5,177		3,492	
Directors' Remuneration	5,000		3,000	
Debenture Interest (gross) to Aye, Ltd.	—		750	
Auditors' Remuneration	320		100	
		10,497		7,342
		55,876		21,070
Balance at January 1, 1950		26,957		4,650
Investment Income (gross)		750		—
Dividend from Ess, Ltd. (gross)		6,000		—
		89,583		25,720
Profits Tax to December 31, 1950	10,160		4,155	
Income Tax 1951–52 (estimated)	24,756		8,907	
General Reserve	20,000		4,200	
Dividends Proposed (net)	12,600		4,200	
		67,516		21,462
Balance at December 31, 1950		22,067		4,258
Balance Sheets :—	£	£	£	£
Fixed Assets at Cost		95,459		34,350
Less Aggregate Depreciation		21,738		7,270
		73,721		27,080
Interests in Subsidiary Company :—				
Shares at Cost	37,500			
5% Debentures	20,000			
Current Account	11,921			
Dividend Proposed (gross)	6,000			
		75,421		—
Current Assets		107,746		71,421
		256,888		98,501
Share Capital—Authorised and Issued		100,000		20,000
Reserves—General		40,845		11,800
Profit and Loss Account		22,067		4,258
Income Tax, 1951–52		24,756		8,907
		187,668		44,965
5% Debentures		—		20,000

	Aye, Ltd.		Ess, Ltd.	
Balance Sheets (*continued*) :—	£	£	£	£
Current Liabilities :—				
Sundry	33,123		7,230	
Profits Tax to December 31, 1950	10,100		4,155	
Income Tax, 1950–51	13,337		5,930	
Current Account—Ess, Ltd.	—		11,921	
Proposed Dividends (net)	12,660		4,200	
		69,220		33,536
		£256,555		[illegible]

Aye, Ltd., acquired 15,000 £1 shares in Ess, Ltd., on January 1, 1950, at £2 10s. per share. At that date Ess, Ltd., had reserves as under :—

	£
General Reserve	7,000
Profit and Loss Account	4,650
Future Income Tax, 1950–51	5,930

On April 1, 1950, Ess, Ltd., issued £20,000 5% Debentures to Aye, Ltd. At December 31, 1950, Ess, Ltd., had in stock goods valued at £9,600 purchased from Aye, Ltd., which sells to its subsidiary at cost plus 20%.

Prepare Consolidated Profit and Loss Account for the year ended December 31, 1950, and a Consolidated Balance Sheet at that date. *Incorporated Accountants.*)

11. Parent Co., Ltd., purchased 90% of the Ordinary Shares in A.B., Ltd., on June 30, 1949, at a cost of £30,000. No Balance Sheet was prepared at the date of acquisition. The Balance Sheet as at December 31, 1948, and December 31, 1949, of A.B., Ltd., was as follows :—

	1948.	1949.		1948.	1949.
	£	£		£	£
Capital, 10,000 Shares	10,000	10,000	Net Assets	30,000	38,000
Revenue Reserves	20,000	22,000	Goodwill	5,000	5,000
Appropriation Account	5,000	11,000			
	£35,000	£43,000		£35,000	£43,000

Parent Co., Ltd.'s, Balance Sheet at December 31, 1949, was as under :—

	£	£		£
Capital		100,000	Subsidiary Co. :—	
Reserves :—			Cost of 9,000 £1 Shares A.B., Ltd.	30,000
Capital	10,000		Other Net Assets	150,000
Revenue	50,000			
		60,000		
Appropriation Account		20,000		
		£180,000		£180,000

Prepare the Consolidated Balance Sheet of Parent Co., Ltd., as at December

12. The following are the Profit and Loss Accounts of Aye, Ltd., and its subsidiaries, Bee, Ltd., and Cee, Ltd., for the year ended December 31, 1948:—

	Aye, Ltd.	Bee, Ltd.	Cee, Ltd.
	£	£	£
Trading Profit for the year before taking into account the items set out below	94,500	40,000	30,000
Investment Income (gross)	1,000	500	—
Profit on Sale of Plant to Cee, Ltd.	—	1,000	—
Proposed Dividends, 1948 (gross) :—			
From Bee, Ltd.	6,400	—	—
Cee, Ltd.	3,600	—	—
	£105,500	£41,500	£30,000
Provisions for Depreciation	10,000	3,500	5,000
Directors' Remuneration	5,000	2,000	2,000
Debenture Interest paid to Aye, Ltd. (gross)	—	—	500
Auditors' Remuneration	500	250	200
	£15,500	£5,750	£7,700
Balance	90,000	35,750	22,300
,, January 1, 1948	8,650	4,200	3,750
	£98,650	£39,950	£26,050
Profits Tax C.A.P. ended December 31, 1948	12,000	5,000	4,000
Income Tax, 1948–49	1,500	500	100
,, 1949–50 (estimated)	37,500	13,500	9,000
Transfer to Reserve	25,000	10,000	7,000
Preference Dividends Year 1948 (net)	1,650	330	275
Proposed Ordinary Dividends Year 1948 (net)	11,000	4,400	2,640
	£88,650	£33,730	£23,015
Balance carried Forward	£10,000	£6,220	£3,035
Issued Share Capital :—			
Preference	£50,000	£10,000	£10,000
Ordinary	£200,000	£100,000	£80,000

Aye, Ltd., holds 80% of the Ordinary Share Capital of Bee, Ltd., and 75% of the Ordinary Share Capital of Cee, Ltd. All the Preference Shares are held outside the group.

You are required to prepare the Consolidated Profit and Loss Account of Aye, Ltd., for the year 1948. (*Incorporated Accountants.*)

13. You are required to prepare the Consolidated Balance Sheet, as at December 31, 1950, of C.G.E. & Co., Ltd., and its two Subsidiaries, B.T.P. & Co., Ltd., and A.O.B. & Co., Ltd.

The Balance Sheets as at December 31, 1950, were as under :—

C.G.E. & Co., Ltd.

	£	£		£	£
Capital and Surplus :—			Fixed Assets . .		28,000
125,000 £1 Shares, fully paid . .	125,000		Investments in Subsidiary Companies, at cost :—		
Revenue Reserves .	18,000		75,000 £1 Shares fully paid, B.T.P. & Co., Ltd. .	85,000	
Profit and Loss Account . . .	16,000	159,000	15,000 £1 Shares, fully paid, A.O.B. & Co., Ltd. .	18,000	103,000
Current Liabilities :—			Current Assets :—		
Account Current with A.O.B. & Co., Ltd..	3,300		Stock in Trade .	12,000	
Others . . .	7,000	10,300	Account Current with B.T.P. & Co., Ltd. . .	8,000	
			Others . . .	18,300	38,300
		£169,300			£169,300

B.T.P. & Co., Ltd.

	£	£		£
Capital and Surplus :—			Fixed Assets . . .	55,000
100,000 £1 Shares, fully paid . .	100,000		Investment in Subsidiary Company, at Cost :—	
Revenue Reserves .	10,000		40,000 £1 Shares, fully paid, A.O.B. & Co., Ltd. .	53,000
Profit and Loss Account . . .	2,000	112,000	Current Assets . . .	16,000
Current Liabilities :—				
Account Current with C.G.E. & Co., Ltd.	7,000			
Others	5,000	12,000		
		£124,000		£124,000

A.O.B. & Co., Ltd.

	£	£		£	£
Capital and Surplus :—			Fixed Assets . .		37,500
60,000 £1 Shares, fully paid . . .	60,000		Current Assets :—		
Revenue Reserves .	7,200		Account Current with C.G.E. & Co., Ltd. . .	3,300	
Profit and Loss Account . . .	5,100	72,300	Others . . .	31,500	34,800
		£72,300			£72,300

The purchases of the investments were all made on June 30, 1950. Immediately prior to the purchase of the investments the Subsidiary Com-

	B.T.P. & Co., Ltd.	A.O.B. & Co., Ltd.
	£	£
Revenue Reserves	9,000	6,000
Profit and Loss Account	1,000	840
Current Liabilities	4,000	—
Fixed Assets	55,000	36,840
Stock-in-Trade	4,000	—
Other Current Assets	55,000	30,000

Dividends have not been declared by any Company during the year ended December 31, 1950, and neither are any proposed.

The whole of the Stock-in-Trade of B.T.P. & Co., Ltd., as at June 30, 1950 (£4,000), was later sold to C.G.E. & Co., Ltd., for £4,400 and remained unsold as at December 31, 1950.

Included in the Account Current of B.T.P. & Co., Ltd., is a charge for interest of £320 which has been credited to C.G.E. & Co., Ltd.

Cash-in-Transit from B.T.P. & Co., Ltd., to C.G.E. & Co., Ltd., was £1,000 as at close of business on December 31, 1950. (*Incorporated Accountants.*)

14. The following are the summarised trial balances as on December 31, 1950, of three finance companies before taking into account any appropriations or final dividends to be recommended by the directors :—

		Adastra, Ltd.	Better, Ltd.	Capit, Ltd.
Credit Balances :—		£	£	£
Issued Share Capitals in Shares of £1—				
Ordinary		1,000,000	600,000	400,000
6% Preference		—	300,000	100,000
5% Preference		500,000	—	—
4½% Debenture Stock		500,000	—	—
Share Premium Account		—	—	100,000
General Reserves as at December 31, 1949		400,000	120,000	40,000
Profit and Loss Account balances, December 31, 1949		95,420	43,200	12,048
Investment Trading Profit for the year ended December 31, 1950		93,505	19,450	7,480
Income from Investments for the year ended December 31, 1950		66,320	61,050	34,820
Interim Dividend on 6% Preference Shares of Better, Ltd., for half-year ended June 30, 1950		3,000	—	—
		£2,658,245	£1,143,700	£694,348
Debit Balances :—		£	£	£
Net Assets other than Interests in Subsidiaries		1,861,440	1,040,400	686,248
Management Expenses		21,805	4,300	5,100
Interim Preference Dividends for Half-year ended June 30, 1950		12,500	9,000	3,000
Debenture Stock Interest		22,500	—	—
Shares in Group Companies, at cost :—				
Ordinary Shares—				
Better, Ltd.	£400,000	400,000	—	—
Capit, Ltd	200,000	240,000	—	—
,,	75,000	—	90,000	—
Preference Shares—				
Better, Ltd.	100,000	100,000	—	—
		£2,658,245	£1,143,700	£694,348

The directors of the various companies recommend that the Preference Dividends for the half-year ended December 31, 1950, should be paid and in addition recommend :—

	Adastra, Ltd.	Better, Ltd.	Capit, Ltd.
Transfers to General Reserve	£50,000	£15,000	£4,000
Ordinary Dividends for year 1950—actual	8%	7½%	6%

The Preference shareholders are only entitled to dividends at the rates stated, and are not entitled to any participation in surplus assets in the event of winding-up.

The share capitals of all companies have remained unchanged since their formation. Adastra, Ltd., subscribed at par for the shares it holds in Better, Ltd., when that company was formed. The shareholdings of Adastra, Ltd., and Better, Ltd., in Capit, Ltd., were purchased (ex 1949 dividend) on January 1, 1950.

It has been decided that the companies in the group should, in accordance with previous practice, take credit for final dividends receivable on inter-company shareholdings.

You are required :—

(*a*) to prepare the Profit and Loss Accounts of Adastra, Ltd., for the year ended December 31, 1950;

(*b*) to prepare the Consolidated Profit and Loss Account of Adastra, Ltd., and its subsidiaries for the year ended December 31, 1950, and

(*c*) to prepare a schedule showing the interest of the minority shareholders in the capital, reserves and undistributed profits of the group, as required for inclusion in the Consolidated Balance Sheet as at December 31, 1950, and to give appropriate wording for this item.

IGNORE TAXATION, DIRECTORS' FEES AND COMPARATIVE FIGURES.

(*Chartered Accountants.*

15. Tins, Ltd., Cans, Ltd., and Boxes, Ltd., are three companies whose financial years end on December 31. On January 1, 1948, Cans, Ltd., purchased 25,000 shares in Boxes, Ltd. On December 31, 1948, Tins, Ltd., purchased the whole of the issued share capital of Cans, Ltd. and on the same date bought from various shareholders other than Cans, Ltd., 25,000 shares in Boxes, Ltd.

Each company prepared draft accounts for the year ended December 31, 1948, and their trial balances after preparing the Profit and Loss Accounts for the year may be summarised thus :—

	Tins, Ltd.	Cans, Ltd.	Boxes, Ltd.
Credit Balances :—	£	£	£
Creditors	46,420	22,700	27,300
Current Account Tins, Ltd. . .	—	15,400	600
,, ,, —Cans, Ltd. . .	—	—	1,350
General Reserve	50,000	10,000	18,000
Overdraft—Western Bank . .	—	12,490	—
Profit and Loss Account at December 31, 1947	16,580	7,600	3,960
Profit and Loss Account—Year ended December 31, 1948	53,280	12,400	10,500
Provision for Depreciation—at December 31, 1948	—	20,000	7,575
Provision for Plant Renewals . .	13,700	—	—
Share Capital—Authorised and Issued in Shares of £1 each . . .	200,000	100,000	75,000
	£379,980	£200,590	£144,285

	TINS, LTD.	CANS, LTD.	BOXES, LTD.
Debit Balances :—	£	£	£
Balances with United Bank	37,350	—	18,510
Cost of Shares in Cans, Ltd.	120,000	—	—
" " Boxes, Ltd.	40,000	45,000	—
Current Account, Cans, Ltd.	15,400	—	—
" " Boxes, Ltd.	3,000	1,350	—
Debtors	61,780	53,000	31,275
Goodwill—at cost	—	21,000	12,000
Plant and Machinery—at cost	62,000	40,000	21,000
Stocks	40,450	40,240	61,500
	£379,980	£200,590	£144,285

You are informed that :—

(i) half the Stock of Cans, Ltd., had been invoiced to that company by Tins, Ltd., at cost plus 33⅓%;

(ii) the difference on current accounts arises from a cheque in course of post at December 31 being dealt with by the receiving company as a January 1949 item; and

(iii) the proposed dividends are Tins, Ltd., 15% and Boxes, Ltd., 10%.

You are required to prepare the Consolidated Balance Sheet of Tins, Ltd., and its subsidiaries as on December 31, 1948. Ignore taxation. (*Chartered Accountants.*)

16. On March 31, 1951, A.B., Ltd., purchased 90,000 Ordinary Shares in C.D., Ltd., for £135,000, the consideration being the issue by A.B., Ltd., of 100,000 Ordinary Shares at a premium of 7*s.* per share.

The Balance Sheet of C.D., Ltd., at December 31, 1951, may be summarised as follows :—

		£		£
Capital, 100,000 Shares of £1 each		100,000	Assets	152,000
Capital Reserve		22,000		
Profit and Loss Account :—				
Balance, December 31, 1950	£7,200			
Profit for year	11,000			
	18,200			
Dividend in respect of 1950, paid June 15, 1951	5,000			
		13,200		
Creditors		16,800		
		£152,000		£152,000

Show how these matters would be dealt with, ignoring taxation, in the books of A.B., Ltd., and in the Consolidated Accounts for the year ended December 31 1951. (*Incorporated Accountants.*)

17. A, B, C, and D form a group of companies, A being the holding company, and the following table shows the issued share capitals of the several subsidiaries, the inter-company holdings and a summary of the reserves appearing in the separate Balance Sheets of the subsidiaries on December 31, 1951 :—

	£	by	£	by	£	by
6% Preference Shares . .	40,000	A.				
,, ,, . .	60,000	O.S.*				
	£100,000		Nil.		Nil.	
Ordinary Shares . . .	400,000	A.	240,000	A.	140,000	B.
,, . . .	100,000	O.S.*	160,000	O.S.*	60,000	C.
	£500,000		£400,000		£200,000	
Reserves in separate Balance Sheets at December 31, 1951 :—						
Capital	100,000		Nil.		Nil.	
Revenue . . .	400,000		200,000		300,000	

* *Note.*—"O.S." above indicates that the shares in question are held b shareholders outside the group.

On June 30, 1952, A bought from outside shareholders a further 80,000 shar in C, bringing their holding up to 320,000.

None of the companies paid interim dividends on any class of shares durin 1952, and the ascertained profits for that year, before any appropriations, were :-

B, £50,000; C, £36,000; and D, £30,000.

Draw up a statement showing the group capital and revenue reserves December 31, 1951, and movements during 1952. (*Chartered Secretaries.*)

18. Company A having an Issued Capital of 500,000 Ordinary Shares of 10 which are quoted on the Stock Exchange at 25*s.*, acquires the entire Sha Capital of Company B, whose Ordinary Shares of £1 are quoted at 47*s.* 6*d.* a are represented by a summarised Balance Sheet as follows :—

COMPANY B.

	£		£
Share Capital—100,000 Ordinary Shares of £1 . .	100,000	Goodwill	20,0
Capital Reserve . . .	20,000	Fixed Assets . . .	60,0
Profit and Loss Account .	30,000	Current Assets, *less* Current Liabilities . . .	70,0
	£150,000		£150,0

The consideration is the issue of two new Ordinary Shares of 10*s.* (with t same rights as those already issued) in Company A for each Ordinary Share of acquired in Company B.

You are required to set out :—

(i) all the relative entries in the first subsequent Consolidated Balan Sheet of Company A and its subsidiary B, giving effect to the above transactio

(ii) Any provisions of the Companies Act, 1948, relating to the applicati of any balances arising.

CHAPTER XIV

DEPARTMENTAL AND BRANCH ACCOUNTS. FOREIGN BRANCH ACCOUNTS

I. DEPARTMENTAL ACCOUNTS.

HEN a selling organisation is conducted on modern lines, whether be a wholesale or a retail organisation, the business is usually subvided for administrative purposes into appropriate departments. hus, for example, a dealer in leather goods may subdivide his business to the following departments: Ladies' Bags, Fancy Goods, Fitted ases, Suit and Attaché Cases, Dog Equipment, Miscellaneous, etc. surance companies are compelled by Statute to departmentalise eir activities as between Life, Fire, Accident, Employers' Liability surance, etc. Departmentalisation is equally applicable to services, ;. piano-tuning, and the division adopted may be founded upon the eas served, or upon any other convenient basis. It is also adapted manufacturing businesses, and the principles are the same. The st aspect is further considered in the chapter on Cost Accounting.

For administrative purposes, this subdivision of activities is usually companied by a corresponding subdivision of the accounting cords in order that the trading results of each department may be certained separately.

Necessity for Subdivision.—In a business which deals in several mmodities, departmental accounts are imperative. Intelligent nagement cannot otherwise be secured. If the business as a whole ows a profit, that is no indication that some of its departments are t being worked at a loss. Experience amply demonstrates that, in s type of business, departments may be run at a loss for long periods known to the management until the fact is brought to notice ough accident, or some outside cause. It is true that, sometimes, a partment is *deliberately* conducted at a loss in order to attract stomers, but though the loss be intentional, the actual cost of this ticular mode of advertisement should be known to the management.

Purchases.—In order to ascertain the trading results of each departnt, the records must be arranged to facilitate analysis. Usually, it nconvenient to keep separate purchases ledgers for each department, ce any one transaction may be distributed over more than one partment. The business will also need a comprehensive survey of dealings with its creditors. This, however, is no bar to the analysis he purchases. Occasionally this analysis is made on the face of the oices, credit being also given for the discount due to each departnt on its share of the invoice. This practice is not commendable, l the analysis of the invoices in a properly ruled Departmental chases Book is more usual and dependable. If one central store is maintained, the goods will usually be issued to individual departments on the imprest system—similar to the method advocated for keeping the Petty Cash, the issues being analysed in an Issues Day Book. As stated above, the purchases should be recorded in a columnar Departmental Purchases Book, ruled as here shown.

DEPARTMENTAL PURCHASES BOOK.

Date.	Invoice No.	Name.	Particulars.	Ledger Folio.	Total.			Department.												Ledger Folio.	Private or Nominal Ledger.		
								A.			B.			C.			D.						
					£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.		£	s.	d.

In modern practice, loose sheets are frequently used for this purpose, and afterwards inserted in a binder for safety until the end of the financial period, when they can be removed to transfer cases for storage. The most modern development is to omit all names and particulars, merely referring to the invoice number. Special adding and tabulating machines may be employed to make the analysis. The total column is used for posting to the personal ledgers and for checking the cross casts. The summations of the analysis columns are posted to a columnar purchases account in the Nominal Ledger, with the exception of the "Private or Nominal Ledger" items. The latter consist of "capital" and similar purchases, and are posted in detail to the appropriate accounts. Returns are similarly dealt with.

Sales.—Where customers buy from one department only, it may be practicable for each department to keep its own sales ledgers, but it more usually happens that each customer's account includes goods from several departments. In such a case, separate ledgers would be impracticable. Moreover, customers generally prefer a combined statement, and the management should know the full extent of each customer's indebtedness. For these reasons, the Sales Ledgers must be centralised in the counting house, and separate Sales Books or Analyses provided. Analysis is generally necessary, as many orders will cover several departments. The necessary analysis may be done either in a Departmental Sales Book, or on loose sheets. Returns inwards must also be suitably analysed in a columnar Departmental Returns Book. The ruling and posting of the Books or Analysis Sheets for departmental sales and returns are similar to those for departmental purchases given above. Cash sales are dissected at the close of each day and recorded in a columnar Departmental Cash Sales Book; from thence they are entered in daily or weekly totals in the General Cash Book and posted to the credit of the respective departments.

If, as not infrequently happens in practice, sectional balancing of the ledgers is employed, a double analysis will usually be necessary. It will be evident that if a customer has credit transactions with more than one department and each customer has (as recommended above) only one ledger account it is impossible to divide the sales ledger on a departmental basis. If there are several sections in the Sales Ledger it is almost certain that the sections will be arranged on either a geographical or an alphabetical basis. Exactly the same difficulty arises in either case. Let us assume the business has five selling departments, which we may call A, B, C, D, and E, and that the ledger is divided for balancing purposes into four sections, identified as W, X, Y, and Z. Then for departmental purposes the sales for each period must be analysed as between A, B, C, D, and E, and for sectional balancing purposes they must also be analysed as between W, X, Y, and Z. The most convenient method of making the analysis, in any given business, must depend on circumstances, but whatever the method it must be such as to give the required figures with certainty and accuracy and without undue expenditure of time on the part of the staff. If, as in the case suggested above, the numbers of the departments on the one hand and sections on the other is not too great, the ruling of the Day Book itself may be extended by simply adding sufficient additional columns. The use of the columns will be evident: one is required for each department and one for each ledger section, as well, of course, as the usual " total " column. A sale by department " B " (say) to a customer whose account is in the " Y " section will be entered (*a*) in the total column, and extended into both the " B " and the " Y " columns. Copy invoices must be marked in such a way as to make these extensions easy and reasonably fool-proof, and the same, of course, applies to any returns (evidenced by credit notes). At the end of the period all columns are cast, and the sum of the totals of the departmental columns must agree with the total of the " total " column. Similarly, the sum of the totals of the " sectional balancing " columns (which are posted, of course, to the control accounts) must agree with the total of the " total column."

The above system is sufficiently self-explanatory, and is the best method to use where the number of columns required is not so large as to render the Day Book uncomfortably wide. When this happens one of the analyses must be carried out in a separate book (or loose-leaf sheets), the necessary agreement of totals being made at as frequent intervals as convenient. Machine accounting, of course, lends itself to still other methods.

Stock.—If stock ledgers are kept, these will be departmentalised, except in respect of goods still in the central store (if any). In any case, stock-taking must be recorded departmentally.

Other Trading Account Debits.—All expenses solely and necessarily incurred in putting goods into saleable condition must be analysed as between the various departments, usually a fairly simple task. *Carriage Inwards* should be attached to the goods on which it is incurred. If a central store is in operation, the issue price can be made to include carriage. *Wages* generally can be definitely charged to the respective departments. *Warehouse Expenses* may have to be apportioned on the turnover of, or the average stock held, or the square feet occupied, or the number of articles sold by, each department, or upon some other equitable basis.

Gross Profit.—Where the accounts are kept on the above basis, departmental trading accounts are easily prepared, and the respective *gross profits* ascertained. In some cases the separation of results is not carried beyond this point, but in others the whole of the expenses are analysed, and the *net profit* of each department is determined.

Departmental Profit and Loss Accounts.—Only in rare cases are the expenses spread evenly over the departments. For this reason, the gross profits shown may not be indicative of the net results achieved. The class of goods, the position occupied by the department in the store, and similar considerations must be taken into account, and it may well happen that a large gross profit is more than absorbed by office and selling expenses. Departmental Profit and Loss Accounts are, therefore, generally speaking, essential, in order to ensure that not only the business as a whole but also each department is earning an adequate net profit. Further, these accounts facilitate the collection and comparison of results period by period, and often disclose valuable information regarding the ratio of expenses incurred by each department, the trend of public taste, seasonal demands, relative working capitals, average yields, etc. The slight additional labour and expense involved in preparing these departmental accounts will almost invariably be more than made good by the additional grip they afford upon the business, revealing as they do where expansion or retrenchment is necessary.

Allocation of Expenses.—Where the expenses are incapable of direct analysis, one or more of the bases mentioned above as applicable for warehouse expenses may be adopted for suitable items of expense, but each item must be judged on its own merits, taking into consideration the circumstances in which it arose. The following general rules are usually applicable:—

(1) *Expenses directly incurred in selling and securing payment for goods should be charged against the departments in proportion to the total sales of each department.*

Office-organisation expenses, travellers' commission and expenses, and superintendence and administration charges fall under this heading. *Discounts* also are usually apportioned on this basis, although, strictly

TRADING AND PROFIT AND LOSS ACCOUNT

Dr.

	Department A.			Department B.			Department C.			Total.		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
To Stock	1,143	16	4	986	14	6	264	12	5	2,395	3	3
,, Purchases	3,465	14	1	3,244	1	3	1,411	2	3	8,120	17	7
,, Transfers				120	1	0	30	0	8	150	1	8
,, Carriage Inwards	18	0	6	18	0	6	9	0	3	45	1	3
	4,627	10	11	4,368	17	3	1,714	15	7	10,711	3	9
,, Balance being Gross Profit carried down	1,734	17	3	1,059	6	0	255	5	0	3,049	8	3
	£6,362	8	2	£5,428	3	3	£1,970	0	7	£13,760	12	0
To Rent, etc.	325	18	7	325	18	7	162	19	4	814	16	6
,, Wages and Salaries	256	14	0	256	14	0	128	7	0	641	15	0
,, Discounts and Allowances	18	16	10	18	16	10	9	8	5	47	2	1
,, Advertising and Catalogues	132	9	9	132	9	10	66	4	11	331	4	6
,, Bad Debts	63	19	11	63	19	10	31	19	11	159	19	8
,, Addition to Bad Debts Provision	2	14	3	2	14	2	1	7	1	6	15	6
,, Printing and Stationery	27	11	9	27	11	9	13	15	10	68	19	4
,, Commission	44	5	7	44	5	7	22	2	10	110	14	0
,, Postages, etc.	37	13	8	37	13	8	18	16	10	94	4	2
,, Insurance	12	2	2	12	2	2	6	1	1	30	5	5
,, General Expenses	42	6	0	42	6	0	21	3	0	105	15	0
,, Depreciation on Furniture	20	0	0	20	0	0	10	0	0	50	0	0
	984	12	6	984	12	5	492	6	3	2,461	11	2
,, Balance carried down being Net Profit for the year	750	4	9	74	13	7	237	1	3	587	17	1
	£1,734	17	3	£1,059	6	0	£255	5	0	£3,049	8	3

Dr.

		£	s.	d.
To Interest on Capital		250	0	0
,, H. Dickson, Share of Profit	£237 13 7			
,, G. Dickson, Share of Profit	237 13 6			
		475	7	1
		£725	7	1

speaking, they are more properly apportionable on the basis of the turnover for the periods in which the relative sales were made. If the turnover is fairly constant and the discounts are small, the results will be approximately accurate; but, in many businesses, the turnover is seasonal, and the " lag " of discount allowances should be taken into account. For example, if three months is allowed for payment, the January sales will be reflected in the April discounts, so that the discounts for the year January 1 to December 31 would be more properly apportioned on the basis of the sales from October 1 to September 30.

(2) *Expenses directly incurred on behalf of any department should be charged to that department.*

Such expenses may include boxes, packing materials, certain insurances, bad debts, special departmental salaries and commissions, departmental catalogues, samples, etc. *Advertising* can generally be allocated to individual departments, but inasmuch as every advertise-

FOR THE YEAR ENDED DECEMBER 31, 19...

Cr.

	Department A.			Department B.			Department C.			Total.		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
By Sales (net)	5,166	2	4	4,428	2	0	1,476	0	8	11,070	5	0
„ Transfers	150	1	8							150	1	8
„ Stock	1,046	4	2	1,000	1	3	493	19	11	2,540	5	4
	£6,362	8	2	£5,428	3	3	£1,970	0	7	£13,760	12	0
By Balance brought down	1,734	17	3	1,059	6	0	255	5	0	3,049	8	3
	£1,734	17	3	£1,059	6	0	£255	5	0	£3,049	8	3

Cr.

	£	s.	d.
By Balance being Net Profit brought down	587	17	1
„ Dividends	120	0	0
„ Interest on Drawings *	17	10	0
	£725	7	1

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* Drawings have been assumed to be made equally over the whole year.

ment usually includes a general " house " advertisement, the proportion of the space occupied by these general advertisements, which benefit the whole business, should be apportioned over all the departments, *e.g.* on the basis of sales. *Depreciation* can generally be directly based upon the value of the assets employed in the department. *Insurance*, according to its kind, will be based upon the value of the assets covered, or the wages paid, etc.

(3) *Expenses chargeable against the business generally, for example, Rent, Rates and Taxes, Lighting and Heating, etc., should be apportioned on the basis of:* (a) *Relative effective square feet occupied by the department, or* (b) *valuation or assessment of the space occupied, or* (c) *relative average value of the stock held by the department, or* (d) *turnover,* i.e. *relative value of the departmental sales, or* (e) *number of articles sold.*

Heating, Lighting, and Power may be based on metered consumption, or the number of lamps, or of points wired, or on the wattage of lamps, or on the effective square or cubic feet occupied, or on the number of machines at work, etc., according to circumstances.

The type of business, the character of the stock, the departmental trading methods employed, and, in retail stores, the relative position of the department must also be considered when allocating expenses under this head. A department on the top floor may have a large window assigned to it on the street level, and may have an efficient lift service, both of which counteract its relatively poor position. Departments dealing in bulky stocks of small value cannot be treated in precisely the same way as departments selling small but costly articles. New departments need treatment somewhat different from fully established departments. The aim must be to make each department bear its just, but no more than its just, share of these expenses, and that calls for the exercise of the judicial virtues. Rent, for example, may be based on floor space occupied, but, in some cases, the relative value of the position occupied by the department should also be taken into account.

(4) *Departments may be charged with interest, calculated on the estimated amount of capital that each department employs.*

The capital sum to be charged with interest is found by adding to the average value of the stock held during a trading period, the average value of the outstanding book debts for the period, and then deducting the average liabilities for the period. When determining the average, the number of times the stock is turned over has to be considered.

Credits to Profit and Loss Account.—The character of the credits and the respective claims of the departments determine the allocation of these items. The necessary analyses are usually most conveniently made on loose sheets, unless the departments are so few in number that analysis columns can be provided in the subsidiary books and ledger accounts.

Inter-departmental Transactions.—Invariably there will occur a number of inter-departmental transfers of goods and or services. It is quite inaccurate to add these transfers to the sales and purchases of the departments concerned, since both will be unduly inflated, and the results will be useless for purposes of comparison, more so if such transfers are considerable. If the goods are transferred at cost, the credit should certainly not be made to the sales of the transferring department; if the transfer is made at selling price, the debit should not be made to the Purchases Account of the receiving department. Both entries should be made to separate Transfers Accounts. Frequently the transfers are made at a price slightly above cost in order to cover the expense of handling. It is obvious, therefore, that transfers should be reduced to a minimum. The various Transfers Accounts will be carried in due course to the Departmental Trading Account (debit-receiving department; credit-issuing department) as separate items in the appropriate department figures, or they will be adjusted in the Purchases Accounts of the departments concerned.

Form of Combined Accounts.—The combined Trading and Profit and Loss Accounts are usually prepared in columnar form, with a column for each department and a total column. The net profits are carried to the General Profit and Loss Account, which usually takes the form of an Appropriation Account. Detailed rulings will be found in *Accounting*, Chapter XVI.

Illustration.—The Trial Balance was extracted as on December 31, 19... from the books of Dickson Brothers, the two partners being equal partners You are required to prepare Departmental Trading and Profit and Loss Accounts and a Balance Sheet.

TRIAL BALANCE, DECEMBER 31, 19...

	Dr.			Cr.		
	£	s.	d.	£	s.	d.
Capital Accounts :—						
H. Dickson				3,333	6	8
G. Dickson				1,666	13	4
Drawings :—						
H. Dickson	400	0	0			
G. Dickson	300	0	0			
Stock, January 1 :—						
Department A	1,143	16	4			
Department B	986	14	6			
Department C	264	12	5			
Purchases (Gross) :—						
Department A	3,465	14	1			
Department B	3,244	1	3			
Department C	1,411	2	3			
Sales :—						
Department A				5,519	9	5
Department B				4,730	19	6
Department C				1,576	19	10
Inter-departmental Transfers :—						
Department A				150	1	8
Department B	120	1	0			
Department C	30	0	8			
Returns Inwards :—						
Department A	353	7	1			
Department B	302	17	6			
Department C	100	19	2			
Wages and Salaries	641	15	0			
Advertising and Catalogues	361	4	6			
Dividends on Shares in XY Co., Ltd.				120	0	0
Shares in XY Co., Ltd.	2,000	0	0			
Sundry Debtors	895	9	8			
Printing and Stationery	48	19	4			
Sundry Creditors				549	5	2
Carriage Inwards	45	1	3			
Commission	110	14	0			
Postages, Telegrams, and Telephone	94	4	2			
Provision for Bad and Doubtful Debts (as at January 1)				30	0	0
Rent, Rates, and Taxes	814	16	6			
Furniture and Fixtures	500	0	0			
Insurance	40	5	5			
General Expenses	105	15	0			
Bank Balance				151	17	7
Discounts and Allowances	47	2	1			
	£17,828	13	2	£17,828	13	2

When preparing the necessary accounts, make the following provisions as on December 31, 19...:—

(1) Credit the partners with interest for the year on their Capital Accounts at 5% per annum. (2) Debit the partners with 5% on their drawings. (3) Write off bad debts amounting to £159 19*s.* 8*d.*, and thereafter increase the provision for doubtful debts to 5% of the book-debts outstanding.

(4) Provide for a stationery account owing at December 31, estimated to amount to £20. (5) Write 10% off the furniture and fittings. (6) Of the £40 5*s*. 5*d*. paid for Insurance Premiums, £10 relates to the period after December 31. (7) The value of the Stocks on hand as on December 31 were as follows: Department A, £1,046 4*s*. 2*d*.; Department B, £1,000 1*s*. 3*d*.; Department C, £493 19*s*. 11*d*. (8) A stock of catalogues remains on hand valued at £30, which has not yet been adjusted in the books. (9) Inter-departmental transfers were made at cost price. (10) All expenses are to be allocated between the departments in the proportion 2 : 2 : 1.

II. Branch Accounts.

Branches may be described as departments conducted at a distance. We are not here concerned with that more modern extension commonly termed a Holding Company (see p. 464) and its subsidiaries, since a subsidiary company has a distinct legal existence, whereas a branch is essentially a part of the business as a whole.

General Principles.—In a general text-book it is not possible or even desirable to attempt to deal with every form of relationship between a Branch and its Parent House, since the exact relationship is determined by the particular needs of the case. All that is attempted here is an explanation of the underlying principles applicable to all cases alike, which, once they are clearly grasped, can easily be adapted to any set of circumstances.

The simple book-keeping system, adequate for the sole trader, with a single office or shop, is naturally inadequate to a series of establishments controlled by a central management. In multiple concerns the buying is generally done by the Head Office, and adequate checks on the honesty and efficiency of the Branch management are necessary if the undertaking is to be controlled effectively.

Requirements of Efficient System.—To be satisfactory, a system of Branch book-keeping should afford:—

(*a*) Facilities for ascertaining at any time the trading results of each branch.

(*b*) Efficient checks on the honesty of the Branch staffs.

(*c*) Prompt information on all matters affecting proper supervision and control.

(*d*) Material for making useful comparisons as between branches and as between trading periods.

Suitable statistical returns must also be devised for dealing periodically with such matters as stock required; orders in hand; orders not yet commenced; special local requirements; customers' complaints; stock on hand; accounts due and overdue; and so on.

The class of business, the distance of the Branch from the Head Office, the perishability of the stock, the possibility of internal check at the Branch, together with the degree of control which is desirable and possible, determine the accounting methods to be adopted. It is obvious that vastly different methods are necessary for such different businesses as Banking, Insurance, Wholesale Provision Merchants, General Carriers, Retail Merchants, to mention a few only. It is

Dickson Brothers

BALANCE SHEET, DECEMBER 31, 19...

		£	s.	d.	£	s.	d.			£	s.	d.
Capital Accounts :—								Furniture and Fixtures	£500 0 0			
H. Dickson		3,333	6	8				*Less* Depreciation	50 0 0			
G. Dickson		1,666	13	4						450	0	0
					5,000	0	0	Shares in XY Co., Ltd.		2,000	0	0
Creditors :—								Stock		2,540	5	4
Trade		549	5	2				Catalogues		30	0	0
Stationery		20	0	0				Sundry Debtors	£735 10 0			
					569	5	2	*Less* Provision for Doubtful Debts	36 15 6			
Bank Overdraft					151	17	7			698	14	6
Current Accounts :—								Insurance in advance		10	0	0
H. Dickson, Interest on Capital	£166 13 4							Current Account, H. Dickson		5	13	1
Share of Profit	237 13 7											
		404	6	11								
Less Drawings	400 0 0											
Interest on Drawings	10 0 0											
		410	0	0								
To contra		£5	13	1								
G. Dickson, Interest on Capital	83 6 8											
Share of Profit	237 13 6											
		321	0	2								
Less Drawings	300 0 0											
Interest on Drawings	7 10 0											
		307	10	0								
					13	10	2					
					£5,734	12	11			£5,734	12	11

proposed to confine this chapter to retail establishments, since the conduct of retail branches is the most complicated, in view of the fact that in addition to cash, stocks are involved.

Kinds of Branches.—Broadly speaking, branches can be divided into two main classes:—

(*a*) Mere selling agencies, keeping no independent accounts other than those relating to sales and petty disbursements.

(*b*) Branches that keep independent books and record all their transactions.

Class (*a*) chiefly consists of businesses dealing in everyday requirements suitable for sale in all or most districts alike; class (*b*) embraces all such businesses as deal in goods that are affected by fashion or local custom, and which, for their effective conduct, require that the Branch Managers shall be allowed some discretion in the purchase of goods.

Methods of Invoicing Goods to Branches.—Three methods are employed when invoicing goods sent from Head Office to the Branches, viz.:—

(*a*) At cost price, *i.e.* in a manufacturing business, at works cost; in a non-manufacturing concern, at net invoice price.

(*b*) At a definite percentage on cost.

(*c*) At the retail selling price of the goods.

Branch as Agency.—Here the Branch may be but a mere feeder of and collector for its Head Office, which executes all orders. Petty disbursements will be dealt with on the imprest system, the imprest being replenished from Head Office. Orders will be entered in carbon duplicating Order Books, and, if the Branch collects accounts due, a Cash Book will be kept to record amounts paid by customers. Head Office will forward periodically to the Branch a schedule of all amounts outstanding. This, frequently, takes the form of carbon copies of the invoices, which can be marked off when paid. Cash received must be banked intact daily, or as often as the branch bank is open. If coin is required for change, a cash "float" should be instituted. Regular periodical returns, usually bi-weekly or weekly, should be sent to the Head Office by the Branch Manager.

Branch as Independent Trader.—A Branch trading independently will execute its own orders, wholly or partly from stock obtained from the Head Office. It may be allowed to make direct purchases, and may collect, and be answerable for, its own book debts, and be allowed to keep a separate banking account and discharge its own liabilities. In such cases, periodical returns and remittances will be made to the Head Office. Stock sent from the Head Office will, in these circumstances, usually be invoiced at cost, or with a slight addition for handling.

The Branch frequently, however, is not allowed to make any purchases or any disbursements other than petty expenses. All stock is supplied from Head Office, the Branch making the sales. In such cases, the Branch may be allowed to keep its own Sales Ledgers and collect amounts due, or this work may be done by the Head Office.

In the latter case copies of all invoices must be forwarded to the Head Office with the bi-weekly or weekly reports. In either case, all cash takings must be banked or remitted direct to the Head Office intact. The Branch will credit Head Office Account with stock and cash received, and debit it with remittances and any returns, discounts, and allowances. Where the Head Office collects the debts, separate Branch Day Books or Summaries of Invoices, and separate Sales Ledgers, and Cash Columns will be instituted.

Central District Depôts.—In a concern with branches widely scattered, it may be necessary to have central warehouses at convenient centres, so that goods may be distributed quickly. In such cases, it may also be convenient to have the accounting centralised at these depôts. Each depôt will be then be similar to an independent branch keeping its own books, and possibly making its own purchases, the Trial Balance of the depôt being incorporated in the Head Office records periodically. The Branches would be accountable to the depôt in the same way as, in smaller concerns, they are accountable direct to the Head Office.

Where the Head Office makes all Purchases.—The remarks made above on departmental transfers are even more applicable to branch transfers. Head Office may be simply a Warehouse and Counting House, or it may run a selling establishment in addition. In the latter case, it is desirable to separate the expenses and accounting of the two sides of the business, since the buying and warehousing expenses are applicable to all branches. The buying and warehousing expenses must, therefore, be charged out to all the branches on an equitable basis, *e.g.* turnover, or, what amounts to much the same thing, by means of a percentage or flat addition to the cost price.

In order to show adequately the accounting methods usually employed, examples and explanations of the working of the more common methods are appended. A Head Office and one or two Branches will be taken, as occasion demands. Head Office is referred to throughout as "H.O."

Illustration 1.—*Branch as agency, collecting orders which are executed from Head Office.*

The Branch collects sums due, and banks receipts intact weekly. Petty expenses are met by an Imprest, and a "float" of £5 is kept at the Branch to provide small change.

Opening position :—

H.O. Books—	£	£
Capital		3,215
Creditors		800
Sundry Assets	1,200	
Stock	900	
Debtors	800	
Cash	100	
Branch Assets	600	
Branch Debtors	400	
Branch Float	5	
Branch Petty Cash	10	
	£4,015	£4,015

The transactions for the four weeks ended January 28, 19.., were as follows: Orders received from Branch and executed, £500; Cash received by Branch, £550; Cash banked by Branch, £500; Purchases, £600; H.O. Sales (all credit), £900; Cost Price of goods invoiced on behalf of Branch (net), £300; Closing Stock, £740; H.O. Receipts from Debtors, £1,200; Discount allowed H.O., £11; Discount allowed Branch, £5; Discount received H.O., £20; Returns Inwards, Branch, £10; Returns Outwards, H.O., £6; H.O. Payments to Creditors, £1,000; Cheque sent by H.O. to reimburse Branch Petty Cash, £8; Expenses (including salaries, etc.), H.O., £145; Expenses paid by H.O. in respect of Branch, £50. Show the Ledger Accounts in H.O. Books, and prepare interim accounts, ignoring outstandings.

Illustration 2.—*The Branch keeps its own books, and forwards a Trial Balance for incorporation in the H.O. books.*

(a) *Where the Branch makes its own purchases, no goods being invoiced from H.O.*

In this case, the Trading and Profit and Loss Account of the Branch is prepared separately (not as part of the H.O. double entry), and the net profit is credited to the General Profit and Loss Account, and debited to the Branch Account in the H.O. books. In the Branch books, Trading and Profit and Loss Account is prepared in the usual way, the net profit being credited to H.O. Account. Any income or expenditure on behalf of the Branch which appears only in the H.O. books must be mutually adjusted through the H.O. and the Branch Accounts prior to the preparation of the Profit and Loss Account. It is important to remember that the H.O. Account in the Branch books is, in effect, the Capital Account of the Branch, and that the Branch Account in the H.O. books represents the H.O. Investment in the Branch. When preparing the combined Balance Sheet, these two internal accounts, being reciprocal, naturally cancel each other, the Branch Account in the H.O. books being replaced in the combined Balance Sheet by the assets and liabilities of which it is composed.

(b) *Where goods are supplied from H.O. at cost.*

In this case the goods sent by H.O. are debited to the Branch Account as and when sent, and credited to a "Goods sent to Branch Account," which is closed by transfer to the credit either of H.O. Trading Account or of Purchases Account. Otherwise the entries are as in (*a*). The Branch debits Purchases Account and credits H.O. with the goods as received; H.O. Account thus takes the place of the Creditors' Personal Accounts.

An approximate check can be imposed by adding the average gross profit realised on each class of goods to the cost price of the goods sold, but this check is practical only where the gross profit is a fixed percentage of the selling price, and the classes of goods sold do not vary greatly.

Illustration 3.—*Where all goods are supplied by H.O., the Branch keeping its own Sales Ledgers and appropriate Sales Books and Cash Books, remitting cash to H.O. daily.*

In this case it is usual for the Branch to send full returns at least once in every four weeks. The H.O. controls the Branch debtors by means of Total Accounts, which form part of the double entry. Goods sent to the Branch are debited to the Branch Transfers Account, and credited to "Goods sent to Branch Account." From the periodical returns, Branch Debtors Account is debited, and Sales Account credited, with the total net credit sales for the period; Branch Account is debited, and Branch Debtors Account credited with the total cash received from debtors; Branch Discounts and Allowances Accounts are debited, and Branch Debtors Account credited with the discounts, etc., allowed to the Branch debtors. If the Branch is permitted to meet its expenses out of receipts, the appropriate Branch Expense Accounts are debited, and Branch Account is credited. Remittances from the Branch are credited to Branch Account, and debited to Cash.

This method is similar to method (2), with the exception that the H.O. books, through the incorporation of the Branch Returns, contain all the

CAPITAL ACCOUNT.

Dr. Cr.

			£	s.	d.				£	s.	d.
						19.. Jan. 1	By Balance		3,215	0	0

CREDITORS.*

Dr. Cr.

			£	s.	d.				£	s.	d.
19.. Jan. 28	To Returns		6	0	0	19.. Jan. 1	By Balance		800	0	0
" 28	" Cash		1,000	0	0	" 1	" Purchases		600	0	0
" 28	" Discount		20	0	0						

SUNDRY ASSETS.*

Dr. Cr.

			H.O.			Branch.						H.O.			Branch.		
			£	s.	d.	£	s.	d.				£	s.	d.	£	s.	d.
19.. Jan. 1	To Balance		1,200	0	0	600	0	0									

STOCK.

Dr. Cr.

			£	s.	d.				£	s.	d.
19.. Jan. 1	To Balance		900	0	0						

DEBTORS.*

Dr. Cr.

			H.O.			Branch.						H.O.			Branch.		
			£	s.	d.	£	s.	d.				£	s.	d.	£	s.	d.
19.. Jan. 1	To Balance		800	0	0	400	0	0	19.. Jan. 28	By Branch					555	0	0
" 31	" Sales		900	0	0	500	0	0	" 28	" Cash and Discount . .		1,211	0	0			
									" 28	" Returns					10	0	0

LEDGER—*continued.*

CASH BOOK.

Dr.			Discount.										Discount.					Cr.
19..			£	s.	d.	£	s.	d.	19..				£	s.	d.	£	s.	d.
Jan. 1	To Balance					100	0	0	Jan. 28	By Creditors			20	0	0	1,000	0	0
,, 28	,, Branch					500	0	0	,, 28	,, Branch :								
,, 28	,, Debtors		11	0	0	1,200	0	0		Petty Cash						8	0	0
										General Expenses						50	0	0
									,, 28	,, H.O. Expenses						145	0	0

BRANCH CHANGE FLOAT.

Dr.											Cr.
19..			£	s.	d.				£	s.	d.
an. 1	To Balance		5	0	0						

BRANCH PETTY CASH.

Dr.											Cr.
19..			£	s.	d.				£	s.	d.
an. 1	To Balance		10	0	0						

BRANCH ACCOUNT.

Dr.											Cr.
9..			£	s.	d.				£	s.	d.
n. 1	To Cash received from Debtors		550	0	0						

LEDGER—*continued.*

PURCHASES.

Dr. | Cr.

Date			£	s.	d.	Date			£	s.	d.
19.. an. 28	To Purchases Book Total		600	0	0	19.. Jan. 28	By Returns		6	0	0

SALES.

Dr. | Cr.

			H.O.			Branch.						H.O.			Branch.		
Date			£	s.	d.	£	s.	d.	Date			£	s.	d.	£	s.	d.
19.. Jan. 28	To Returns					10	0	0	19.. Jan. 28	By Sales Book		900	0	0	500	0	0

REMITTANCES FROM BRANCH.

Dr. | Cr.

Date			£	s.	d.	£	s.	d.	Date			£	s.	d.
									19.. Jan. 28	By Cash		500	0	0

DISCOUNT.

Dr. | Cr.

			H.O.			Branch.						H.O.			Branch.		
Date			£	s.	d.	£	s.	d.	Date			£	s.	d.	£	s.	d.
19.. Jan. 28	To Branch					5	0	0	19.. Jan. 28	By Cash Book		20	0	0			
,, 28	,, Cash Book		11	0	0												

EXPENSES.

Dr. | Cr.

			H.O.			Branch.											
Date			£	s.	d.	£	s.	d.				£	s.	d.	£	s.	d.
19.. Jan. 28	To Cash		145	0	0	58	0	0									

INTERIM TRADING AND PROFIT AND LOSS ACCOUNT FOR THE FOUR WEEKS ENDED JANUARY 28, 19...

Dr.	H.O. £	s.	d.	Branch £	s.	d.	Cr.	H.O. £	s.	d.	Branch £	s.	d.
o Stock	900	0	0				By Sales (net)	900	0	0	490	0	0
,, Purchases (net)	294	0	0	300	0	0	,, Stock	740	0	0			
,, Gross Profit carried down	446	0	0	190	0	0							
	£1,640	0	0	£490	0	0		£1,640	0	0	£490	0	0
o General Expenses	145	0	0	58	0	0	By Gross Profit brought down	446	0	0	190	0	0
,, Discounts	11	0	0	5	0	0	,, Discounts	20	0	0			
,, Net Profit	310	0	0	127	0	0							
	£466	0	0	£190	0	0		£466	0	0	£190	0	0

BALANCE SHEET, JANUARY 28, 19...

	£	s.	d.			£	s.	d.
ipital	3,215	0	0	Sundry Assets:				
editors	374	0	0	H.O.	£1,200 0 0			
rofit and Loss Account	437	0	0	Branch	600 0 0			
						1,800	0	0
				Stock		740	0	0
				Debtors:				
				H.O.	£489 0 0			
				Branch	335 0 0			
						824	0	0
				Cash at Bank		597	0	0
				Cash at Branch		65	0	0
	£4,026	0	0			£4,026	0	0

information necessary for the preparation of the final accounts, with the exception, of course, of the closing stock, which is dealt with in the usual manner.

Stock at Loaded Prices.—So far, the entries for supplies of stock have been dealt with at cost prices. But, as already mentioned, it may be desirable and more convenient to invoice the goods sent to a Branch at a price exceeding cost, or at the selling price for such goods, in order: (*a*) to keep a check upon the Branch, and (*b*) to prevent the branch staff from learning the exact profit upon sales, and how it is made up. Where selling price is adopted for invoicing, the Branch manager has always to account for the goods received either in cash or stock in hand, because, as is clear, the stock in hand should always equal the initial stock *plus* purchases *less* sales. An effective check is thus established. Variations in price are dealt with by additional charges or allowances made to the Branch. Almost invariably, however, there will be a margin of error in the closing stock due to loss in issuing small quantities, spoilage, errors of price, damaged stock, and other causes. But experience will permit a limit to be placed upon this margin, and, if the limit is exceeded, immediate investigation should follow.

The adjustments in the H.O. books made necessary by invoicing goods to Branches in excess of cost are dealt with as follows:—

(a) *Goods invoiced at Selling Prices.*—On January 1, 19..., goods costing £5,000 are invoiced to a Branch and charged up at a selling price designed to produce a gross profit of 33⅓%. The Branch report on January 28 following shows that the cash sales were £3,000, and the credit sales £3,300. Also that goods invoiced at £60 have been returned to H.O., and the closing stock is £1,128. Record these transactions.

BRANCH GOODS ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Jan. 1	To Sundries	7,500	0	0	19... Jan. 28	By Sales	6,300	0	0
						" Returns	60	0	0
						" Stock carried down	1,128	0	0
						" Adjustment Account, loss in Stock	12	0	0
		£7,500	0	0			£7,500	0	0
19... Jan. 29	To Stock brought down	1,128	0	0					

GOODS SENT TO BRANCH ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Jan. 28	To Returns	40	0	0	19... Jan. 1	By Branch	5,000	0	0

BRANCH ADJUSTMENT ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19...					19...				
Jan. 28	To Branch (33⅓% on £60)	20	0	0	Jan. 1	By Branch (33⅓% on £7,500)	2,500	0	0
	„ Branch Loss	12	0	0					
	„ Balance (33⅓% on £1,128)	376	0	0					
	„ Gross Profit carried to Profit and Loss Account	2,092	0	0					
		£2,500	0	0			£2,500	0	0
					19...				
					Jan. 29	By Balance brought down	376	0	0

Another method sometimes adopted for the Branch Account, where goods are transferred at retail selling prices, is shown as under:—

The Universal Tobacco Stores, Ltd., opened a branch shop in Tokenhouse Yard, London, E.C., and debited all supplies at selling price. Goods were supplied as follows: June 1, £402 16*s.* 9*d.*; June 13, £84 2*s.* 2*d.*; June 20, £117 18*s.* 9*d.*; June 27, £212 14*s.* 6*d.* The Branch forwarded to the Head Office the following cash takings: June 8, £72 4*s.* 8*d.*; June 15, £81 2*s.* 2*d.*; June 22, £114 6*s.* 2*d.*; June 30, £105 14*s.* 9*d.* The Branch retained £20 in cash on June 30, and paid £15 for expenses out of that week's takings. Show the accounts in the Head Office books as on June 30, assuming that stock on hand at the Branch (value, at selling price, £409 4*s.* 5*d.*) cost £302 1*s.* 9*d.*

HEAD OFFICE BOOKS

BRANCH ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19...					19...				
June 1	To Goods at Selling Price	402	16	9	June 8	By Cash from Branch	72	4	8
„ 13	„ Goods at Selling Price	84	2	2	„ 15	„ Cash from Branch	81	2	2
„ 20	„ Goods at Selling Price	117	18	9	„ 22	„ Cash from Branch	114	6	2
„ 27	„ Goods at Selling Price	212	14	6	„ 30	„ Cash from Branch	105	14	9
					„ 30	„ Expenses paid at Branch	15	0	0
					„ 30	„ Balance carried down: Stock on hand valued at selling price	409	4	5
						Cash in hand at Branch	20	0	0
		£817	12	2			£817	12	2
19...									
July 1	To Balance brought down:— Stock on hand at Selling Price	409	4	5					
	Cash in hand at Branch	20	0	0					

GOODS SENT TO BRANCH.

Dr. Cr.

		£	s.	d.			£	s.	d.
19...					19...				
June 30	To Transfer to H.O. Combined Trading Account, being Branch Sales for the month . .	408	7	9	June 30	By Total Goods sent to Branch, valued at selling price . .	817	12	2
" 30	" Stock on hand at Branch, valued at selling price, carried down . . .	409	4	5					
		£817	12	2			£817	12	2
					19...				
					June 30	By Stock on hand at Branch, valued at selling price, brought down . . .	409	4	5

COMBINED TRADING ACCOUNT.

(Head Office and Branch.)

Dr. Cr.

		£	s.	d.			£	s.	d.
					19...				
					June 30	By Branch Sales, Tokenhouse Yard . .	408	7	9
					" 30	" Stock on hand at Branch, valued at cost	302	1	9

COMBINED PROFIT AND LOSS ACCOUNT.

(Head Office and Branch.)

Dr. Cr.

		£	s.	d.			£	s.	d.
19...									
June 30	To Branch Expenses, Tokenhouse Yard . .	15	0	0					

The Stock on Hand is carried down in the Branch Account and in the Goods Sent to Branch Account at selling price. The balance of the Goods Sent to Branch Account therefore represents the sale price of the goods sold, and can be transferred to General Trading Account. The carrying down of the unsold stock at selling prices in the Goods Sent to Branch Account neutralises the bringing down of the same item on the opposite side of the Branch Account. The stock on hand at the Branch can be brought into the combined Trading Account at cost, in the manner ordinarily employed in Trading Accounts. Any difference in the closing stock must be adjusted in the Branch, and Goods Sent to Branch Accounts, in order that the exact Balance in Hand may be carried down. Advantages claimed for invoicing goods to Branches at selling prices are: (*a*) the cost price of goods is not disclosed, and (*b*) the system affords a simple check upon the manager, who has to account for his initial stock plus purchases less sales and final stock.

(b) *Goods issued at a Percentage above Cost.*—On January 1, goods costing £5,000 are invoiced to a Branch at 20% above cost. The Branch report on January 28 shows that the cash sales amounted to £3,000, credit sales to £3,300, and cash received from debtors to £2,300. Goods invoiced at £60 had been returned by the Branch to H.O. The closing stock at the Branch amounted to £900 at invoice prices. Show the records of these transactions, assuming that all cash has been remitted to H.O. as received.

BRANCH GOODS ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19..					19..				
an. 1	To Sundries . .	6,000	0	0	Jan. 28	By Cash . .	3,000	0	0
	,, Balance, being apparent gross profit	1,260	0	0	,, 28	,, Debtors . .	3,300	0	0
					,, 28	,, Returns . .	60	0	0
					,, 28	,, Stock carried down . .	900	0	0
		£7,260	0	0			£7,260	0	0
19...									
an. 29	To Stock brought down . .	900	0	0					

GOODS SENT TO BRANCH ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19...					19...				
an. 28	To Returns . .	50	0	0	Jan. 1	By Branch . .	5,000	0	0

BRANCH ADJUSTMENT ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19..					19...				
n. 28	To Returns 20% on £50 . . .	10	0	0	Jan. 1	By Branch (20% on £5,000) . .	1,000	0	0
,, 28	,, Balance carried down (16⅔% on £900) . .	150	0	0	,, 1	,, Apparent Gross Profit . .	1,260	0	0
,, 28	,, Profit and Loss Account, being Gross Profit .	2,100	0	0					
		£2,260	0	0			£2,260	0	0

CASH ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
...									
28	To Cash Sales . .	3,000	0	0					
28	,, Debtors . .	2,300	0	0					

BRANCH DEBTOR'S ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Jan. 28	To Sales . . .	3,300	0	0	19... Jan. 28	By Cash. . .	2,300	0	0
					,, 28	,, Balance carried down . .	1,000	0	0
		£3,300	0	0			£3,300	0	0
19... Jan. 29	To Balance brought down . .	1,000	0	0					

Confusion sometimes arises in examination work in determining the percentage to be eliminated from closing stock in order to reduce it to cost under the systems outlined above. A little reflection should make it clear that when a percentage has been added to cost, the *same* percentage deducted from the increased amount will not reduce it to cost. If £100 is taken as cost, and 25% is added thereto, the amount becomes £125. The proportion to be deducted in order to reduce the amounts to cost is, therefore, $\frac{25}{125}$, *i.e.* $\frac{1}{4}$ has been added to the cost, therefore $\frac{1}{5}$ must be taken away from the selling price. Students should also carefully note whether the percentage is calculated on cost or on selling price.

Double-column Branch Accounts.—In order to avoid use of a Branch Adjustment Account, the Branch Goods Account may be ruled with double columns, the inner column being used as a memorandum column to record the invoice price and to control the goods, the outer column being, in effect, the Trading Account of the Branch. Applying this method to the examples on pp. 596 and 599, the records are as on p. 601.

Goods Sent to Branch Account must be closed off to the credit of Trading Account or Purchases Account in the H.O. books in order to show the true result of the H.O. trading.

The "One-account" System.—A method sometimes adopted is to combine all the Branch transactions in one account, which includes all stock, sales, debtors, etc. An example is appended:—

	£
Goods invoiced at cost to Branch	48,400
Returns to H.O	100
Stock, January 1	6,000
Cash Sales	12,000
Credit Sales for the year	45,800
Allowance to customers	50
Discounts allowed to customers	110
Bad Debts	40
Rent, Rates, and Taxes	500
Returns from customers	200
Wages and Salaries	800
Debtors, January 1	5,500
Stock, December 31	8,500
Sundry Expenses	1,100
Cash received on Ledger Accounts	44,900
Debtors, December 31	6,000

BRANCH GOODS ACCOUNT.

Dr.		Invoice Price.								Invoice Price.					Cr.
19...		£	s.	d.	£	s.	d.	19...		£	s.	d.	£	s.	d.
Jan. 1	To Sundries	7,500	0	0	5,000	0	0	Jan. 28	By Sales	6,300	0	0	6,300	0	0
,, 28	,, Gross Profit				2,092	0	0	,, 28	,, Returns	60	0	0	40	0	0
								,, 28	,, Stock carried down	1,128	0	0	752	0	0
								,, 28	,, Apparent Loss	12	0	0			
		£7,500	0	0	£7,092	0	0			£7,500	0	0	£7,092	0	0
19... Jan. 29	To Stock brought down	1,128	0	0	752	0	0								

GOODS SENT TO BRANCH ACCOUNT.

Dr.															Cr.
19...		£	s.	d.	£	s.	d.	19...		£	s.	d.	£	s.	d.
Jan. 28	To Returns				40	0	0	Jan. 1	By Branch				5,000	0	0

Example (*b*).

BRANCH GOODS ACCOUNT.

Dr.															Cr.
19...		£	s.	d.	£	s.	d.	19...		£	s.	d.	£	s.	d.
Jan. 1	To Sundries	6,000	0	0	5,000	0	0	Jan. 28	By Sales	6,300	0	0	6,300	0	0
,, 28	,, Gross Profit	1,260	0	0	2,100	0	0	,, 28	,, Returns	60	0	0	50	0	0
								,, 28	,, Stock carried down	900	0	0	750	0	0
		£7,260	0	0	£7,100	0	0			£7,260	0	0	£7,100	0	0
19... Jan. 29	To Stock brought down	900	0	0	750	0	0								

GOODS SENT TO BRANCH ACCOUNT.

Dr.															Cr.
19...		£	s.	d.	£	s.	d.	19...		£	s.	d.	£	s.	d.
Jan. 28	To Returns				50	0	0	Jan. 1	By Branch				5,000	0	0

BRANCH ACCOUNT (ON A CASH BASIS).

Dr. Cr.

		£	s.	d.			£	s.	d.
19...					19...				
Jan. 1	To Balance :—				Dec. 31	By Cash :—			
	Stock	6,000	0	0		From Debtors .	44,900	0	0
	Debtors . . .	5,500	0	0		Cash Sales . .	12,000	0	0
Dec. 31	,, Goods from H.O. .	48,400	0	0	,, 31	,, Returns to H.O. .	100	0	0
,, 31	,, Rent, Rates, and Taxes	500	0	0	,, 31	,, Balance carried down :			
,, 31	,, Wages and Salaries .	800	0	0		Stock . £8,500			
,, 31	,, Sundry Expenses .	1,100	0	0		Debtors 6,000			
,, 31	,, Profit and Loss Account, net profit .	9,200	0	0			14,500	0	0
		£71,500	0	0			£71,500	0	0
19..									
Jan. 1	To Balance brought down .	14,500	0	0					

It will be seen that the above account is simply a combination of all the accounts which in former examples were shown under separate headings. The disadvantages of this method are also apparent, as the H.O. cannot arrive at the true facts of the trading without a great deal of analysis.

Suspense Account.—Where the Branch keeps records of goods, etc., passing between it and H.O., the Branch Account in the H.O. books and the H.O. Account in the Branch books should agree. But when the H.O. and Branch are far apart there is usually, at balancing times, a residuum of entries initiated by the one and not responded to by the other, *e.g.* goods or cash sent by the H.O. but not, at balancing time, received by the Branch. The statements passing between the offices at balancing times should be promptly checked against the reciprocal ledger accounts, and all items unresponded to should be transferred to a Suspense Account in the H.O. books for items in transit. The Branch Accounts will then show like balances, and the combination of the trial balances may be proceeded with. After balancing, the suspense items can be retransferred to the Branch Account. An alternative method of treatment is to carry down the items in transit as a balance on the Branch Account itself.

When preparing the final accounts, items in suspense should be included in the General Balance Sheet under their proper headings. Thus goods in transit should be included in the General Balance Sheet as "Stock." Vague headings, such as "Items in Transit," should be avoided.

Inter-Branch Accounts.—Large undertakings with Branches in all parts of the world may require inter-Branch Accounts, thereby complicating the preparation of the combined Balance Sheet, but the principles remain the same. It is the rule in some businesses for the Branches to settle inter-Branch transactions through the H.O., thereby avoiding the necessity for inter-Branch Current Accounts. Each Branch credits H.O. with all goods or remittances received from any other Branch, and debits H.O. with all goods or remittances sent to any other Branch.

Rules for Reconciling Branch Current Accounts.—The difficulty sometimes experienced in reconciling the accounts of a Branch remote from the H.O. is reduced if definite arrangements are made to facilitate the process.

It should be clearly understood, for example, which office is to render statements to the other, and which is to check and reconcile them. It ought, too, to be the rule that complete advices of all entries should be promptly forwarded by the originating house, and equally promptly responded to by the recipients, whether actually terminated on receipt of the advice or not. A Reconciliation Statement should be prepared at periodical intervals, the process following much the same lines as that adopted when reconciling the Cash and Bank Pass Books. The statement rendered, say by the Branch, is checked against the Branch Account in the H.O. books, and all items in transit in either direction are collected and totalled. The statement may work backwards or forwards in point of date; the essential thing is that the balances should be proved to agree.

Duplicate Branch Ledger.—Though it is true that by means of the reciprocal Adjustment Accounts the Branch books may be kept at any desired place, it is occasionally found that, even when a Branch is allowed to keep its own books, the H.O. prefers to duplicate the Branch books in its own counting house for purposes of discipline and control. This involves the despatch, by the Branch to the H.O., of complete copies of the Branch Cash Accounts and Journal entries. The Branch Ledger, when written up by the H.O. from these sources, is chiefly of a memorandum nature. If the Branch entries are very numerous, the keeping of a duplicate ledger is impracticable, and, even when it is possible, the practice is liable to break down, owing to the Branch failing to supply complete details. At the best, this method of control involves a great deal of labour, and for this reason it is seldom resorted to, except as a means of supervision in an emergency, or when the book-keeping capacity of the staff is not of a high order.

On p. 608 an illustration is given of a set of H.O. and Branch Accounts. Each Branch kept its own Sales Records, etc., forwarding reports to H.O. every four weeks, and these have been combined with the H.O. accounts in the manner shown, after the inter-house accounts have been eliminated.

MULTIPLE-SHOP CONCERNS.

In multiple-shop companies, the Branch trade is usually almost wholly a cash trade, and the commodities, *e.g.* drugs, tobacco, boots, etc., are saleable at fixed prices. Concentration of buying and distribution generally effects economy, and, where possible, it is usual to stock multiple shops from a central warehouse, but district centres may be necessary where perishable goods form the stock-in-trade.

The Check System.—In these circumstances, an excellent check can be imposed upon the Branch by invoicing the goods supplied to the Branch at selling prices, so that the Branch is always accountable for a definite amount in cash, book debts or unsold stock or a combination of the three. If the check afforded by this arrangement is efficiently applied, leakage due to fraud or mismanagement is readily detected. To yield the maximum benefit, the method must be supplemented by independent stock-taking, at uncertain and unheralded intervals, by a travelling inspector and his staff. Frequently a weekly Stock Return is sent by the Branch to H.O.

In many instances, the Branch stocks are kept on the imprest system, whereby a fixed amount of goods is kept at the Branch, and weekly returns (bi-weekly or every other day in the case of perishable goods) are made to H.O., which replenishes the stock of the Branch to replace the actual sales made. Stock-taking is thus greatly facilitated.

Method of Accounting.—Whether the accounts are kept by one central office or by various district offices, the method is the same. The entries are initiated by the Branch manager's weekly returns of sales, disbursements, goods received from the H.O., and the weekly stock-requisition note. A Weekly Return and a Stock Requisition are illustrated on p. 605. The latter is in triplicate. One copy is retained by the Branch manager, another is filed at the central warehouse as an order, and the third is returned as an invoice for the goods sent to the Branch. The H.O. debits the Branch Account in the H.O. books with the total value of the goods at selling prices, and the Branch registers itself either in its Ledger or Stock Book as responsible for the same value. If the Branch is permitted to sell damaged or out-of-date stock at less than the original selling price, a credit note should be sent by the H.O. to adjust the Branch books. Returns should be treated in the same way. Occasionally a "Branch Supplies Journal" is kept, wherein supplies to Branches are entered at both cost and selling prices, accommodation for both particulars being provided in the Branch Account in the Ledger. This form of Journal is illustrated at p. 606.

Cash Sales.—In retail Branches cash sales are the rule and credit sales the exception. In order to keep a check upon cash sales, each shop assistant is given an official number and a carbon check book. These check books, containing from 50 to 100 numbered check forms in duplicate, are kept under lock and key; and, when issuing them, the manager dates and initials them and records their issue in a Checks Issued Book. The usual form of check is too well known to need illustration. It is used as a kind of invoice to record details of a sale, and, to ensure accuracy, it is usually initialled by a shop-walker or fellow assistant before being handed to the customer. The check

Branch...............

WEEKLY RETURN FOR THE WEEK ENDING ...., 19...

Dr.

	£	s.	d.	£	s.	d.
To Cash Sales:						
Monday						
Tuesday						
Wednesday						
Thursday						
Friday						
Saturday						
,, Cash from Head Office . .						
,, Other receipts . . .						
,, *Stock received during week £* ...... as per advice note No. . .						
,, *Stock in hand £* ...... as per schedule herewith . . .						
,, *Stock required £* ...... as per requisition sheet herewith . .						

Cr.

	£	s.	d.	£	s.	d.
By Cash paid to Bank:						
Monday						
Tuesday						
Wednesday						
Thursday						
Friday						
Saturday						
,, Wages						
,, Incidentals . . .						
,, Travelling . . .						
,, Postage, etc. . .						
,, Balance in hand						

Branch ....

GOODS REQUIRED BY ...., 19...

Quantity.	Particulars of goods.	Cost.				Selling.			
		Price per article.	Amount.			Price per article.	Amount.		
			£	s.	d.		£	s.	d.

Note.—Selling prices only are filled in by the local manager, cost prices being unknown to him, and only selling prices appear in the copy returned with the goods. The copy filed at the central warehouse contains both cost and selling prices.

BRANCH SUPPLIES JOURNAL.

Week ending July 31, 19...

Date.	No. of invoice.	Branch.	Cost prices.																Goods at selling prices.									
			Goods.																									
			Folio.	Debits.			Credits, returns, etc.			Net debit.			Packing materials.			Trade ex-penses.			Folio.	Debits.			Credits.			Net debit.		
				£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.	£	s.	d.

book is provided with an index, which is written up by the assistant as the sales are made, and totalled at the end of the day. The system is similar to that in general use by the majority of up-to-date concerns doing a cash trade, whether conducted by multiple-shop organisations or by sole traders.

Depreciation of Assets.—Depreciation necessarily written off any fixed assets which belong to a Branch is frequently dealt with in the H.O. Depreciation Account only; in other cases, it is charged against the particular Branch. If the assets are recorded only in the H.O. books, under the latter system, the adjustment must be made through the Current Accounts.

Warehouse Expenses.—As already mentioned, a percentage may be added to the cost price of the goods to cover warehouse expenses. Frequently, however, this is not practicable; and it is then necessary to apportion them over the Branches, usually on the basis of turnover, taking into account, of course, the nature of the goods. A grocery establishment may have one Branch running a Bakery from which other Branches are supplied. A Branch may run a tea-shop in addition to the grocery and bakery business. Another Branch may run a bacon-curing factory, supplying the other Branches. In such cases, the inter-Branch transfers should be at wholesale prices, otherwise the bakery and bacon-curing factory will be seriously prejudiced. Moreover, all inter-Branch transfers should be accounted for through the H.O. in order to keep track of the transactions, and minimise disputes.

Minor Complications.—In small country towns and villages, the check on the Branch manager is rendered much more difficult than in larger shops where several assistants are employed. The manager may be alone, or have one or two young girls as assistants. He frequently lives on the premises, and may also be the local postmaster—all circumstances which render the check on the cash more difficult. It is imperative in such cases to keep stocks as low as possible, in order to keep a check on the goods consumed by the manager's household. Where the Branch Bank is open only once or twice a week, customers frequently make use of the shop to cash cheques. Whilst this should be discouraged and reduced to a minimum, maintenance of goodwill renders it impossible to stop the practice altogether. Records of the cheques so cashed should be kept so that the bankings can be agreed.

Final Accounts.—The Final Trading, and Profit and Loss Accounts, and Balance Sheet, can be prepared in columnar form with total columns, although it is usually unnecessary to show the Balance Sheet in this form.

Illustration.—Uprichards, Ltd., is a retail grocery business, with a Head Office (divided into Warehouse and Selling Departments) and three

Branches. All purchases are made by Head Office, and transfers are made at selling price to the branches. Some of the goods are delivered direct to the branches, but all invoices pass through H.O. only. Branch A, in addition to the grocery business, runs a bakery from which the other branches are supplied. Each branch keeps its own Sales Books, Cash Books, and Sales Ledger, and all moneys received are banked intact. Wages and other petty expenses are paid through petty cash, which is kept on the imprest system and replenished from H.O. weekly. Every four weeks a report is forwarded by the Branch Managers to H.O.

The reports for the four weeks ended January 28 provide the following information:—

	Head Office Selling Department.	Branch.		
		A.	B.	C.
alance, Petty Cash in hand, January 1	£ 420	£ 200	£ 150	£ 100
ash from Debtors	6,000	4,000	3,500	5,000
ash Sales	3,500	2,500	2,800	3,200
ash Banked	9,200	6,300	6,000	8,000
edit Sales	8,000	5,000	4,000	5,500
ansfers to Branches at selling prices :				
From Warehouse to	11,000	9,000	8,000	8,000
From A to	300	—	200	100
From B to	100	—	—	—
From C to	—	150	—	—
urchases . . £26,000				
ages, etc.	350	150	120	80
undry Expenses	50	30	20	10
eques for Imprest Petty Cash from H.O.	400	180	140	90

Wages and Sundry Expenses at H.O. are apportionable between the Warehouse and the Selling Department in the ratio of 3 : 2. A uniform charge of 10% on sales is charged to all Branches, including H.O. Selling Department, for handling and storage expenses in the warehouse, use of motors, vans, etc., and clerical labour.

In addition to the above, the following payments were made by H.O.:—

	£
Buyer	60
H.O. Manager	40
Motor Expenses	200
Stable Expenses	140
General Expenses (including clerical salaries)	4,000
Creditors	20,000
No allowances were made, but Discounts received were	3,000
Discounts allowed were—	
H.O.	60
Branch A	45
Branch B	35
Branch C	46
The outstanding General Expenses amounted to	1,800

The Trial Balance at January 1 was as follows:—

	Dr.			Cr.		
	£	s.	d.	£	s.	d.
Share Capital				100,000	0	0
Sundry Creditors (Trade)				25,000	0	0
Profit and Loss Account				8,000	0	0
Commission Accounts—						
Branch A				300	0	0
Branch B				200	0	0
Branch C				200	0	0
Managing Director				1,000	0	0
Buyer				250	0	0
H.O. Manager				350	0	0
Freehold Land and Buildings—						
Head Office	10,000	0	0			
Branch A	8,000	0	0			
Leasehold Land and Buildings—						
Branch B	5,000	0	0			
Branch C	6,000	0	0			
Goodwill (H.O., at cost)	15,000	0	0			
Motor Vans, etc. (H.O.)	1,500	0	0			
Trade Fittings, Utensils, etc.—						
Head Office	400	0	0			
Branch A	300	0	0			
Branch B	300	0	0			
Branch C	200	0	0			
Horses, Carts, and Harness (H.O.)	400	0	0			
Sundry Debtors (Trade)—						
Head Office	4,500	0	0			
Branch A	2,600	0	0			
Branch B	2,700	0	0			
Branch C	3,600	0	0			
Unexpired Insurances, Rates, etc. (expire March 31)—						
Head Office	100	0	0			
Branch A	80	0	0			
Branch B	80	0	0			
Branch C	70	0	0			
Stock at Cost—						
H.O. Warehouse, at cost	35,000	0	0			
H.O. Selling Department, at selling price	7,500	0	0			
Branch A	7,500	0	0			
Branch B	6,000	0	0			
Branch C	9,000	0	0			
Branch Adjustment Accounts—						
H.O. Selling Department				2,500	0	0
Branch A				2,500	0	0
Branch B				2,000	0	0
Branch C				3,000	0	0
Investments	10,000	0	0			
Cash at Bank	8,600	0	0			
Petty Cash in Hand—						
Head Office	420	0	0			
Branch A	200	0	0			
Branch B	150	0	0			
Branch C	100	0	0			
	£145,300	0	0	£145,300	0	0

Open the necessary ledger accounts, which would be kept in the H.O. books; post the information given above; and prepare interim Trading, and Profit and Loss Accounts, and a Balance Sheet. The average "mark-up" is 33⅓% on Selling Price, excepting bread. This, however, is taken as being the same to allow for transfer at wholesale prices from the bakery. Ignore Depreciation, and work to the nearest £.

SHARE CAPITAL ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
					19... Jan. 1	By Balance	100,000	0	0

SUNDRY TRADE CREDITORS CONTROL ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19...					19...				
Jan. 28	To Cash	20,000	0	0	Jan. 1	By Balance	25,000	0	0
,, 28	,, Discount	3,000	0	0	,, 28	,, Purchases	26,000	0	0

PROFIT AND LOSS APPROPRIATION ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
					19...				
					Jan. 1	By Balance	8,000	0	0

COMMISSION ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
					19...				
					Jan. 1	By Balances :—			
						Branch A	300	0	0
						Branch B	200	0	0
						Branch C	200	0	0
						,, Managing Director	1,000	0	0
						,, Buyer	250	0	0
						,, H.O. Manager	350	0	0

FREEHOLD LAND AND BUILDINGS.

Dr. Cr.

		£	s.	d.			£	s.	d.
19...									
an. 1	To Balance :—								
	Head Office	10,000	0	0					
	Branch A	8,000	0	0					

LEASEHOLD LAND AND BUILDINGS.

Dr. Cr.

		£	s.	d.			£	s.	d.
19...									
an. 1	To Balance :—								
	Branch B	5,000	0	0					
	Branch C	6,000	0	0					

GOODWILL (H.O.).

Dr. Cr.

		£	s.	d.			£	s.	d.
19...									
an. 1	To Balance	15,000	0	0					

MOTOR VANS, ETC. (H.O.).

Dr. Cr.

		£	s.	d.			£	s.	d.
19...									
an. 1	To Balance	1,500	0	0					

TRADE FITTINGS, UTENSILS, ETC.

DR.		H.O.	A.	B.	C.			H.O.	A.	B.	CR. C.
		£	£	£	£			£	£	£	£
19... Jan. 1	To Balance	400	300	300	200						

HORSES, CARTS, HARNESS, ETC. (H.O.).

DR.		£	s.	d.			£	s.	CR. d.
19... Jan. 1	To Balance	400	0	0					

SUNDRY TRADE DEBTORS.

DR.		H.O.	A.	B.	C.			H.O.	A.	B.	CR. C.
19...		£	£	£	£	19...		£	£	£	£
Jan. 1	To Balance	4,500	2,600	2,700	3,600	Jan. 28	By Cash	6,000	4,000	3,500	5,000
,, 8	,, Sales	8,000	5,000	4,000	5,500	,, 28	,, Discount	60	45	35	46

RENT, RATES, TAXES, INSURANCE, ETC.

DR.		H.O.	A.	B.	C.			H.O.	A.	B.	CR. C.
		£	£	£	£			£	£	£	£
19... Jan. 1	To Balance	100	80	80	70						

INVESTMENTS.

DR.		£	s.	d.			£	s.	CR. d.
19... Jan. 1	To Balance	10,000	0	0					

CASH BOOK.

Dr. Cr.

19..		£	s.	d.	19..		£	s.	d.
Jan. 1	To Balance	8,600	0	0	Jan. 28	By Petty Cash	810	0	0
,, 28	,, Branches	29,500	0	0	,, 28	,, Buyer	60	0	0
					,, 28	,, H.O. Manager	40	0	0
					,, 28	,, Motor Expenses	200	0	0
					,, 28	,, Stable Expenses	140	0	0
					,, 28	,, General Expenses	4,000	0	0
					,, 28	,, Creditors	20,000	0	0

PETTY CASH.

Dr. Cr.

19..		H.O.	A.	B.	C.	19..		W'hse.	H.O.	A.	B.	C.
		£	£	£	£			£	£	£	£	£
Jan. 1	To Balance	420	200	150	100	Jan 28	By Wages and Expenses	240	160	180	140	90
,, 28	,, Cash	400	180	140	90							

BRANCH CASH ACCOUNTS.

Dr. Cr.

19..		H.O.	A.	B.	C.	19..		H.O.	A.	B.	C.
		£	£	£	£			£	£	£	£
Jan. 28	To Debtors	6,000	4,000	3,500	5,000	Jan. 28	By Bank	9,200	6,300	6,000	8,000
,, 28	,, Cash Sales	3,500	2,500	2,800	3,200						

SALES ACCOUNTS.

Dr. Cr.

		H.O.	A.	B.	C.	19..		H.O.	A.	B.	C.
		£	£	£	£			£	£	£	£
						Jan. 28	By Cash	3,500	2,500	2,800	3,200
						,, 28	,, Credit	8,000	5,000	4,000	5,500

BRANCH TRANSFER DAY BOOK.

Dr.		H.O.	A.	B.	C.			W'hse.	H.O.	A.	B.	Cr. C.
19...		£	£	£	£	19...		£	£	£	£	£
Jan. 28	To Transfers	11,000	9,000	8,000	8,000	Jan. 28	By Transfers	36,000				
,, 28	,, Transfers	300		200	100	,, 28	,, Transfers			600		
,, 28	,, Transfers	100				,, 28	,, Transfers				100	
,, 28	,, Transfers		150			,, 28	,, Transfers					150

BRANCH TRANSFER ACCOUNTS.

Dr.		W'hse.	H.O.	A.	B.	C.			W'hse.	H.O.	A.	B.	Cr. C.
19..		£	£	£	£	£	19...		£	£	£	£	£
Jan. 28	To Sundries		11,400	9,150	8,200	8,100	Jan. 28	By Sundries	36,000		600	100	150
,, 28	,, Branch Goods Account	36,000					,, 28	,, Branch Goods Account		11,400	8,550	8,100	7,950

BRANCH ADJUSTMENT ACCOUNTS.

Dr.		W'hse.	H.O.	A.	B.	C.			W'hse.	H.O.	A.	B.	Cr. C.
19...		£	£	£	£	£	19...		£	£	£	£	£
Jan. 28	To Transfers	12,000					Jan. 1	By Stocks		2,500	2,500	2,000	3,000
							,, 28	,, Transfers		3,800	2,850	2,700	2,650

BRANCH GOODS ACCOUNTS.

Dr.		H.O.	A.	B.	C.			W'hse.	H.O.	A.	B.	Cr. C.
19...		£	£	£	£	19...		£	£	£	£	£
Jan. 1	To Balance	7,500	7,500	6,000	9,000	Jan. 28	By Transfers	36,000				
,, 28	,, Transfers	11,400	8,550	8,100	7,950							

STOCK ACCOUNT.

Dr.		£	s.	d.			£	s.	Cr. d.
19...									
Jan. 1	To Balance, at cost	35,000	0	0					

Date		£	s.	d.	Date		£	s.	d.
19... Jan. 28	To Sundry Creditors	26,000	0	0					

SALARIES AND WAGES ACCOUNT.

Dr.		W'hse.	H.O.	A.	B.	C.			W'hse.	H.O.	A.	B.	Cr. C.
		£	£	£	£	£			£	£	£	£	£
19... Jan. 28	To Petty Cash . .	210	140	150	120	80							
" 28	" Cash . . .	60	40										

SUNDRY EXPENSES.

Dr.		W'hse.	H.O.	A.	B.	C.			W'hse.	H.O.	A.	B.	Cr. C.
		£	£	£	£	£			£	£	£	£	£
19... Jan. 28	To Petty Cash . .	30	20	30	20	10							
" 28	" General Expenses .		1,150	750	680	870							

GENERAL EXPENSES.

Dr.		£	s.	d.			£	s.	Cr. d.
19... Jan. 28	To Cash :—				19... Jan. 28	By Branches, 10% on Sales	3,450	0	0
	Motor	200	0	0					
	Stable	140	0	0					
	General	4,000	0	0					

DISCOUNTS.

Dr.		W'hse.	H.O.	A.	B.	C.			W'hse.	H.O.	A.	B.	Cr. C.
		£	£	£	£	£			£	£	£	£	£
19... Jan. 28	To Sundries . .		60	45	35	46	19... Jan. 28	By Sundries . .	3,000				

Note.—In practice separate accounts would be opened for each type of expense.

INTERIM TRADING AND PROFIT AND LOSS ACCOUNTS FOR THE FOUR WEEKS ENDED JANUARY 28, 19...

DR.

	W'hse.	H.O.	A.	B.	C.
	£	£	£	£	£
To Stock	35,000	5,000	5,000	4,000	6,000
,, Purchases	26,000				
,, Transfers		7,600	5,700	5,400	5,300
,, Gross Profit		3,833	2,500	2,267	2,900
	£61,000	£16,433	£13,200	£11,667	£14,200
To Salaries and Wages		180	150	120	80
,, Sundry Expenses *		1,203	807	727	903
,, Discounts		60	45	35	46
,, Net Profit carried down		2,390	1,498	1,385	1,871
		£3,833	£2,500	£2,267	£2,990

CR.

	W'hse.	H.O.	A.	B.	C.
	£	£	£	£	£
By Sales		11,500	7,500	6,800	8,700
,, Transfers	24,000				
,, Stocks	37,000	4,933	5,700	4,867	5,500
	£61,000	£16,433	£13,200	£11,667	£14,200
By Gross Profit		3,833	2,500	2,267	2,900
		£3,833	£2,500	£2,267	£2,900
By Balance brought forward					8,000
,, Net Profit brought down					7,144
,, Over-allocation Expenses					10
					£15,154

BALANCE SHEET, JANUARY 28.

	£	s.	d.	£	s.	d.
Share Capital (details)				100,000	0	0
Creditors :—						
Trade	28,000	0	0			
Commissions	2,300	0	0			
General Expenses	1,800	0	0			
				32,100	0	0
Profit and Loss Account :—						
Balance brought forward	8,000	0	0			
Net Profit † for period	7,154	0	0			
				15,154	0	0
				£147,254	0	0

	£	s.	d.	£	s.	d.
Goodwill				15,000	0	0
Freehold Land and Buildings				18,000	0	0
Leasehold Land and Buildings				11,000	0	0
Motor Vans, etc.				1,500	0	0
Horses, Carts, Harness, etc.				400	0	0
Trade Fittings, etc.				1,200	0	0
Stock				58,000	0	0
Sundry Debtors				17,214	0	0
Unexpired Insurance, etc. (say)				220	0	0
Investments				10,000	0	0
Bank Balance				12,850	0	0
Cash :—						
Petty Cash	£870	0	0			
Unbanked	1,000	0	0			
				1,870	0	0
				£147,254	0	0

The value of the Stock is arrived at as follows:—

	H.O.	A.	B.	C.
	£	£	£	£
Branch Goods Account balances	18,900	16,050	14,100	16,950
Branch Sales Account balances	11,500	7,500	6,800	8,700
Stock at Selling Prices	7,400	8,550	7,300	8,250
Deduct 33⅓%	2,467	2,850	2,433	2,750
Stock at Cost Price	£4,933	£5,700	£4,867	£5,500

When preparing the final accounts, the *actual* Stock figure, as found by valuation, will be taken, any adjustment for differences being put through the Adjustment Accounts.

The over-allocation of General Expenses arises as follows:—

	£
General Expenses	4,340
Warehouse Salaries, etc.	270
Warehouse Expenses	30
Outstanding General Expenses	1,800
	6,440
Deduct Discounts received	3,000
Actual Expenses	3,440
Allocated	3,450
Over-allocation	= £10

As only Interim Accounts are being prepared, no actual transfers, other than those shown, should be made.

EXAMINATION QUESTIONS.

1. Describe a system of departmental accounts, and give its object. (*Chartered Accountants.*)

2. What are departmental accounts? What advantages are to be derived om such accounts? Give *pro-forma* Trading and Profit and Loss Accounts f a business divided into three departments, and state how you have allocated te indirect expenses of the business as between the various departments. (*hartered Institute Secretaries.*)

3. If a firm having three departments desires to ascertain the separate profits f each, in what way would you suggest that the purchases and sales should be orded? If you recommend special forms of books, give specimen rulings for any articular business. (*Chartered Accountants.*)

4. The proprietors of a large retail store which is divided into departments sk you to design a system of accounts which, whilst showing the result of the orking of each department, also provides a ready co-ordination in the work of he various departments, *e.g.* where goods have to be supplied to a customer pon the same order but from several departments, or where there is a necessary nterchange of goods between departments. Write a report of not more than words with your recommendations, giving samples of any rulings which you ay think necessary. (*Incorporated Accountants.*)

5. X and Y, merchants, carry on their business through five departments, numbered 1 to 5. During their first trading period the results are:—

	Departments.				
	1	2	3	4	5
	£	£	£	£	£
Purchases	25,000	15,000	5,000	13,000	17,000
Sales	24,000	10,500	4,750	11,500	15,000
Stock on hand . .	6,000	7,000	1,000	3,000	6,000

The expenses which are to be charged to each department in proportion to the purchases for that department are as follows:—

	£
Salaries and Commissions	2,750
Rent and Rates	750
General Expenses	600
Insurances	250

Show the final result and the percentages on sales in each department, and also the combined results with percentage on total sales. (*Incorporated Accountants.*)

6. From the following Trial Balance prepare in departmental form the Trading and Profit and Loss Account of the Splendax Plate and Cutlery Company. The business is divided into two departments, viz. Plate and Cutlery. Also prepare a Balance Sheet at June 30.

TRIAL BALANCE, JUNE 30.

	Dr.			Cr.		
	£	s.	d.	£	s.	d.
Cash	1,112	4	6			
Goodwill	3,000	0	0			
Share Capital paid up, 3,000 £10 Shares, £5 paid				15,000	0	0
Sundry Debtors	8,111	19	4			
Sundry Creditors				3,421	12	2
Stock, July 1 previous year:—						
Plate Department	5,111	11	4			
Cutlery Department	3,002	8	9			
Purchases:—						
Plate Department	4,112	19	5			
Cutlery Department	5,111	4	3			
Returns Inwards:—						
Plate Department	111	2	2			
Cutlery Department	36	1	3			
Sales:—						
Plate Department				10,335	2	8
Cutlery Department				5,148	1	6
Salaries	1,516	14	9			
Rent, Rates, and Taxes	411	19	6			
Gas, Water, and Electric Light	111	2	3			
Discounts	51	2	9			
Printing and Stationery	162	14	0			
Postage, Telegrams, and Telephone . . .	76	4	9			
General Expenses	211	16	3			
Carriage (on Sales)	64	3	3			
Bills Receivable	724	5	1			
Advertising	865	2	6			
	£33,904	16	4	£33,904	16	4

Note.—Value of Stock on hand at June 30: Plate Department, £2,119 8*s.* 5*d.*; Cutlery Department, £5,007 17*s.* 5*d.*

Expenses, except Advertising, are to be apportioned between the two departments according to their net sales. The cost of advertising is to be apportioned £660 to the Plate Department, and £205 2*s.* 6*d.* to the Cutlery Department.

7. A. Brown is a coal merchant, and also carries on a ticket agency. From the following particulars make out his Profit and Loss Account for the year in departmental form, showing the net profit on the two departments of his business: Stock of Coal on hand, January 1, £35; Coal Purchases, £864; Coal Sales, £1,343; Stock of Coal on hand, January 31, £62; Wages of Carmen and Coal-heavers, £180; Repairs to Coal-carts and Harness, £15; Depreciation written off Horses, £24; Depreciation written off Carts and Harness, £12; *Office Rent, Rates, and Taxes, £37; *Office Salaries, £102; Postages, Telegrams, and Telephone, £17; Advertising and Posters, £12; *Depreciation of Office Furniture, £3; Commissions received on sale of Railway Tickets, £17; Commissions received on sale of Steamship Passages, £148.

Note.—Items marked * are to be apportioned equally between the two departments. Apportion the Postages, Telegrams, and Telephone £13 to the Coal Department and £4 to the Ticket Department, and the cost of Advertising and Posters is chargeable entirely to the Coal Department.

8. Z. & Co. carry on business as chemical manufacturers and makers of patent medicines. From the following particulars make out their Trading and Profit and Loss Account, showing the net profits made respectively in their Chemical and Patent Medicine Departments during the year: Stock, January 1: Chemicals Department, £104; Patent Medicines, £121. Purchases of Raw Materials: Chemicals Department, £1,418; Patent Medicines, £78. Sales to the Public: Chemicals Department, £2,419; Patent Medicines, £3,074. Manufactured Chemicals supplied by Chemicals Department to Patent Medicines Department for further use in manufacture there, £814. Factory Wages and Salaries: Chemicals Department, £832; Patent Medicines, £416. Bottles, Cases, and Labels: Chemical Department, £37; Patent Medicines, £75. Factory Rent, Rates, and Taxes, £223; Government Duty Stamps on Patent Medicines, £50; Power, Light, and other Factory Charges, £122. Stock, December 31: Chemicals Department, £248; Patent Medicines, £75. Office Salaries, £400; Office Rent, Rates, and Taxes, £188; Travellers' Commissions and Expenses, £214; Gas, Coal, and Electric Light (Office), £36; Printing and Stationery, £102; General Expenses, £6 1*s.*; Advertising, £652; Bad Debts, £35.

Notes.—Apportion Factory Rent, Rates, and Taxes, and Power, Light, and other Factory Charges between the departments on a basis of the wages paid in each.

Apportion all Office and other non-productive expenses, except Advertising and Bad Debts, between the two departments on a basis of the sales effected by each, counting goods supplied by one department to the other for use in manufacture as being sales.

£50 of the Advertising expenses and £5 of the Bad Debts are chargeable against the Chemicals Department, the remainder relate to the Patent Medicine business.

9. Messrs. Babble & Co. publish two daily newspapers, the *Morning Screech* and the *Evening Houl.* From the following particulars prepare accounts showing the net trading result of each journal for the year: Gross Sales: *Screech*, £51,000; *Houl*, £39,000. Returns, to be deducted from gross sales: *Screech*, £15,000; *Houl*, £4,000. Cost of Editorial Staff: *Screech*, £5,000; *Houl*, £4,000. Payments to Contributors and Correspondents: *Screech*, £22,000; *Houl*, £14,000. Payments to News Agencies for News Supplied: *Screech*, £10,000; *Houl*, £6,000. Receipts for Advertisements: *Screech*, £40,000; *Houl*, £30,000. Cost of Advertisement Manager's Department (to be apportioned in proportion to the Advertisement receipts), £7,000. Cost of Paper used: *Screech*, £5,000; *Houl*, £4,000. Printing Department (*Salaries and Wages, £18,000; Repairs and Renewals, £1,000; Stores and Supplies, £1,000; Printing Office Rent, Rates, and Taxes,

£2,000; General Expenses, £2,000; Lighting and Power, £500; Depreciation of Plant, £1,000; Sundry Expenses, £1,500), £27,000. Delivery Department: *Wages, Salaries, Motor Expenses, and General Expenses, £3,000.

Note.—Apportion Expenditure under the headings marked * in proportion to the Gross Sales.

10. From the following Trial Balance prepare the Profit and Loss Account and Balance Sheet of L. Smith, a manufacturer whose business is divided into two departments, viz. " A " and " B," for the year. These accounts are to be shown so as to reveal the result of the operations of each department separately as well as the combined result. The expenses appearing in the Profit and Loss Account are to be apportioned as between the two departments according to the net volume of sales for the year in each department.

	Dr.			Cr.		
	£	s.	d.	£	s.	d.
Freehold Land and Buildings	20,500	0	0			
Plant and Machinery	14,396	0	0			
Sundry Debtors	2,914	0	0			
Sundry Creditors				23,246	9	5
Manufacturing Wages :—						
Department A	3,294	9	1			
Department B	5,291	4	9			
Manufacturing Charges :—						
Department A	2,046	14	2			
Department B	3,096	4	8			
Stock on hand, January 1 :—						
Department A	2,049	16	2			
Department B	5,629	14	3			
Salaries of Counting House Staff	2,249	10	0			
Rates, Taxes, and Insurance	635	9	9			
General Expenses and Commissions	1,524	18	5			
Capital Account, L. Smith				30,000	0	0
Cash at Bank and in hand	10,454	7	1			
Sales :—						
Department A				11,324	9	5
Department B				16,986	14	1
Purchases :—						
Department A	4,396	2	1			
Department B	3,294	1	9			
Returns Outwards, Department B				214	19	3
	£81,772	12	2	£81,772	12	2

Note.—The value of the Stock on hand as on December 31 was as follows: Department A, £3,092 17*s.* 6*d.*; Department B, £4,924 10*s.* 9*d.*

11. From the following Trial Balance of Messrs. X. and Y.'s Stores prepare a Trading Account showing the gross profits made by the three departments (A, B, and C) into which it is divided. Also prepare a Profit and Loss Account and a Balance Sheet.

Make the following provisions at December 31: (1) Credit the partners with interest for the year on their Capital Accounts at 5% per annum; no interest is to be charged on drawings. (2) Write off Bad Debts amounting to £99 8*s.* 9*d.*, and thereafter increase the Provision for Bad and Doubtful Debts to 5% of the balance of debts outstanding. (3) Provide for a stationery account owing at December 31, estimated to amount to £20. (4) Write 10% off the Furniture and Fixtures. (5) Of the £23 9*s.* 5*d.* paid for Insurance Premiums, £10 relates to the period after December 31. (6) Stock on hand at December 31: Department A, £612 4*s.* 9*d.*; Department B, £104 2*s.* 2*d.*; Department C,

Messrs. X. & Y.'s Stores.

TRIAL BALANCE, DECEMBER 31.

	Dr.			Cr.		
	£	s.	d.	£	s.	d.
Capital Accounts :—						
X.				2,400	0	0
Y.				1,200	0	0
Drawings :—						
X.	350	0	0			
Y.	300	0	0			
Stock, January 1 :—						
Department A	651	4	6			
Department B	121	2	2			
Department C	1,316	9	8			
Purchases (Gross) :—						
Department A	2,212	4	6			
Department B	1,116	5	0			
Department C	2,949	1	1			
Sales :—						
Department A				2,602	4	2
Department B				1,595	15	11
Department C				4,160	2	9
Transfers of Stock between departments :—						
(From) Department A				100	0	5
(To) Department B	20	0	5			
(To) Department C	80	0	0			
Returns Inwards :—						
Department A	10	0	0			
Department B	30	0	9			
Department C	110	17	1			
Wages and Salaries	411	2	2			
Advertising and Catalogues	240	4	6			
Dividends on Shares in M N Company				60	0	0
Shares in M N Company	1,000	0	0			
Sundry Debtors	559	8	9			
Printing and Stationery	12	1	9			
Sundry Creditors				349	2	5
Carriage	38	4	6			
Commission	82	9	8			
Postages, Telegrams, and Telephone	47	2	1			
Provision for Bad and Doubtful Debts (as at January 1)				10	0	0
Furniture and Fixtures	300	0	0			
Insurance	23	9	5			
General Expenses	84	2	9			
Cash at Bank	335	9	10			
Discounts and Allowances	46	2	1			
	£12,477	5	8	£12,477	5	8

£1,112 8*s.* 9*d.* (7) A stock of Catalogues remains on hand valued at £30, the cost of which is included in the item of "Advertising and Catalogues, £240 4*s.* 6*d.*"

12. The Olympian Patent Medicine Company manufacture two varieties of patent medicine, viz. "Hercules" ointment and "Jupiter" pills. From the following particulars prepare the Company's Trading and Profit and Loss Account for the year, showing the gross and net profits or losses on each class of manufacture: Stock of Drugs on hand, January 1: Ointment, £600 10*s.*; Pills, £80 2*s.* 2*d.* Stock of Bottles, Wrappers, and Labels, January 1: Ointment, £125 15*s.* 6*d.*; Pills, £15 2*s.* 9*d.* December 31, Purchase of Drugs: Ointment, £884 2*s.* 9*d.*; Pills, £246 8*s.* 2*d.* Bottles, Wrappers, and Labels: Ointment, £625 8*s.* 2*d.*; Pills, £122 8*s.* 4*d.* Manufacturing Expenses: Ointment, £1,146 2*s.* 6*d.*; Pills, £422 8*s.* 6*d.* Sales: Ointment, 256,020 boxes at 6*d.* each;

Pills, 42,114 boxes at 1*s*. each. Stock of Drugs, Bottles, and Wrappers on hand at December 31, 19...; Ointment, £81 18*s*. 11*d*.; Pills, £81 4*s*. 11*d*. Advertising, £2,484 9*s*.; Postage, Stationery, and Printing, £207 0*s*. 9*d*.; Salaries, £414 1*s*. 6*d*.; Rent, Rates, and Taxes, and General Expenses, £621 2*s*. 3*d*. Apportion the four last-mentioned expenses between the two classes of goods according to the *number of boxes* of ointment or pills *sold*.

13. Show how you would combine the Balance Sheets and interchanging accounts of a concern having separate trading centres in London, Liverpool, and Manchester. (*Chartered Accountants.*)

14. Describe how you would treat the Accounts of Branches in the Head Office Books of a multiple-shop firm. (*Incorporated Accountants.*)

15. Miles, Further & Co., Ltd., own twenty retail provincial branches. All goods are supplied from the London Head Office, and are charged out at selling prices.

The Head Office request you to devise a Supplies Journal which will record in convenient form: (*a*) Supplies to Branches (cost and selling prices); (*b*) Returns and allowances; and (*c*) Cost of packing and despatch.

Submit a suitable ruling for the above requirements, explain the advantages you claim for it, and make two specimen entries therein. (*Royal Society Arts.*)

16. A company owning 500 branch shops instruct you to prepare a suitable system of accounts. Simplicity is of the first importance, as the knowledge of accounts of the Branch Managers is very limited. The company deal in five main commodities and sundries.

You are instructed to prepare forms of accounts, so that weekly Profit and Loss Accounts may be prepared, continuous stocks kept, and cost accounts giving quantities for each branch. Give: (*a*) Form of accounts to be kept at each shop; (*b*) Weekly accounts to be forwarded to the Head Office; (*c*) Head Office book of statistics. (*Incorporated Accountants.*)

17. Smith, Jones & Co. are the owners of a business working upon the multiple-shop system. No branch is allowed to purchase any Stock and can make only Petty Cash payments. All receipts are paid daily to the Credit of the firm at the local bank.

Upon what basis should goods be charged out to the Branches?

Explain the records which the Head Office Books would show in the case of each Branch. (*Incorporated Accountants.*)

18. A company, having its Head Office in London, owns a factory in South Africa. During the year 19..., £10,000 in cash has been remitted from London to the factory, and bills for £5,000, drawn by the manager in South Africa on the Head Office, have been accepted. At the end of the year it is found that there has been a loss on the working of the factory of £2,000, which is transferred to the Head Office. Show the entries in the Head Office books recording these transactions. (*Chartered Accountants.*)

19. Messrs. Baxter & Sons, whose Head Office is in London, remitted £500 to their Manchester Branch on December 30. The books of the Head Office and the Branch are balanced as on December 31 each year. The above-mentioned remittance did not reach Manchester until the morning of January 1, following. How would you deal with the amount in question in the Trial Balances of the Head Office and Branch and when preparing the combined Balance Sheet of the whole business? (*London Chamber Commerce.*)

20. A. B. & Co., of London, possess several branch shops. A weekly sum is remitted to meet salaries and expenses. All goods are supplied from the Head Office, and no local purchases are permitted. All receipts are banked locally as and when received, and the local managers have no power to draw upon these banking accounts. The bulk of the sales are for cash, but a few credit sales are also effected, and are collected locally when due.

You are required to submit a form of weekly Branch Return suitable to furnish the Head Office with all the necessary information.

21. The Roget Cigarette Company, Ltd., proposes to open twenty retail shops in various towns for the sale of: (*a*) Cigarettes, (*b*) Tobacco, and (*c*) Pipes and Sundries.

All goods are to be supplied from a central warehouse in London. No local purchases of goods are to be allowed.

You are required to draft instructions for the Head Office book-keeper: (a) As to the records to be kept in the Head Office books regarding goods forwarded to the branches; (b) As to the returns to be made to the Head Office by the branches; and (c) As to the best method of dealing with cash payments for expenses paid locally. (*London Chamber Commerce.*)

22. **A. B. & Co.'s Stores.**

TRIAL BALANCE, DECEMBER 31.

	Head Office.		Manchester Branch.		Liverpool Branch.		Hull Branch.	
	£	£	£	£	£	£	£	£
Stock, January 1	850		450		425		275	
Goodwill	5,000							
Freehold Premises	6,500							
A. Capital Account		7,804						
B. Capital Account		7,804						
Sales		7,000		5,834		5,412		4,210
Purchases	5,000		4,228		4,000		3,000	
Sundry Debtors	658		631		567		455	
Sundry Creditors				300		275		162
Trade Expenses	78		70		63		32	
Salaries and Wages	600		450		250		250	
Rates and Taxes	139		105		150		73	
Provision for Bad and Doubtful Debts		501						
Bad Debts	38		30		22		22	
Repairs	150							
Postages	30		21		14		11	
Liverpool		197						
Manchester		166						
Hull		251						
Head Office			166		197		251	
Investments	4,000							
Income from Investments		320						
Cash at Bank	1,000							
	£24,043	£24,043	£6,134	£6,134	£5,688	£5,688	£4,372	£4,372
Stock, December 31	884	—	550	—	450	—	300	—

From the above Trial Balances prepare Trading and Profit and Loss Accounts and Balance Sheet of the partnership. (*Incorporated Accountants.*)

23. Weston Wheeler, a retail trader, has three shops. His books show the following particulars at the close of his financial year on March 31:—

	Bath.	Birmingham.	Bristol.
	£	£	£
Stock, April 1, previous year	2,000	3,000	1,000
Wages	350	250	300
Rent	200	350	250
Sales	5,000	4,000	3,000
Stock, March 31	2,000	4,000	1,500

His total Purchases were £10,500 and General Expenses £480. His buyer fixes the selling price of the goods by adding to the cost price of the goods the same percentage throughout the Branches. His general expenses are borne by each shop in proportion to its turnover. Show the net profits of each shop.

24. In the Balance Sheet of a company submitted to you for audit, you find, amongst others, the following items:—

	£
Creditors in London (Head Office)	10,000
Due to Manchester Branch	2,000
Due to Glasgow Branch	1,000
	£13,000

	£
Debtors in London (Head Office)	15,000
Due from Liverpool Branch	3,000
Due from Birmingham Branch	1,800
Due from Belfast Branch	200
	£20,000

What adjustments, if any, would you require before certifying? (*Chartered Accountants.*)

25. The X Z Company, of London, has a Branch at Newcastle-on-Tyne. Goods sold at Newcastle are supplied from London, but no charge is made in the books as between the Branch and Head Office. On December 31, the Branch Balance Sheet, after closing the books, was as follows:—

Dr.	£	Cr.	£
Sales Ledger Balances	46,700	Bought Ledger Balances	3,290
Premises Extension Account, closed to Head Office	0	Head Office	44,720
Cash in hand	50		
Cash at Bank	1,260		
	£48,010		£48,010

In the six months to June 30 next, the following transactions took place at the Branch: Sales, £54,180; Purchases, £4,200; Wages (paid), £5,700; Salaries, £560; Directors' Fees, £200; Fire Insurance Premium for one year, £480; Cash collected on account Sales Ledger Accounts, £42,000; Discount allowed on account Sales Ledger Accounts, £2,500; Cash paid Bought Ledger Accounts, £3,800; Cash sent to London, £29,560; Premises Extension, further payments to Contractors, £1,500.

There is Cash in hand on June 30, £60, and a Bank Balance, £1,450.

Set out the Head Office Account in the Newcastle books on June 30, to show the entries after the books are closed, and also the Branch Balance Sheet at that date, assuming it to be made up on the same lines as on December 31. (*Chartered Accountants.*)

26. The Southern Trading Company, Ltd., has a Head Office at London and a Branch at Southampton. From the following Trial Balances prepare a combined Balance Sheet of the whole undertaking.

LONDON TRIAL BALANCE, DECEMBER 31.

	Dr.			Cr.		
	£	s.	d.	£	s.	d.
Cash	511	12	6			
Stock on hand	2,214	9	8			
Sundry Debtors	5,616	4	2			
Sundry Creditors				314	1	9
Furniture and Fixtures	322	9	1			
Share Capital, 10,000 £1 Shares, fully paid				10,000	0	0
Profit and Loss Account:—						
Balance, January 1				111	19	6
Profit for year				711	19	8
Southampton Branch	2,473	5	6			
	£11,138	0	11	£11,138	0	11

SOUTHAMPTON TRIAL BALANCE, DECEMBER 31.

	Dr. £ s. d.	Cr. £ s. d.
Cash	411 12 6	
Sundry Debtors	3,112 9 5	
Sundry Creditors		2,442 1 9
Stock on hand	1,111 14 2	
London Office		1,674 1 8
Profit for year		519 12 8
	£4,635 16 1	£4,635 16 1

The difference between the London Office balance in the Branch books and the latter's balance in the London Office books is accounted for by the fact that London remitted £700 cash to Southampton on December 31 and forwarded to Southampton goods invoiced at £99 3*s.* 10*d.*, both of which did not reach Southampton until January 1 following.

27. The Manager of a Branch Office receives a cheque each month from the proceeds of which he has to discharge: (*a*) the monthly trade accounts; (*b*) salaries and office expenses.

With regard to receipts, he collects local accounts (with instructions to pay the same daily to the credit of Head Office at Bank).

Upon investigation it is found: (1) That all monthly accounts due to the firm are one month in arrear, and that the dates of vouchers have been altered to correspond with the false entries in the Branch Cash Book (copies of entries being forwarded to Head Office weekly). (2) That the Manager has paid to each employee only half a month's salary, explaining as his reason that Head Office had short-remitted him, owing to an error in the additions, made by Head Office, in the monthly Schedule of accounts payable. (3) That the Manager has collected accounts in cash, paying part only of the proceeds to Head Office account at Bank.

You are requested to draft a scheme which, in your judgment, will prevent a repetition of such frauds. (*Incorporated Accountants.*)

III. Foreign Branch Accounts.

Here we are concerned with the keeping and preparation of accounts involving the element of foreign exchange, and the complications incident thereto.

The explanations previously given in regard to Branch Accounts where both the parent house and the branches operate in the same country apply also when the Head Office is domiciled in this country, and the branch in a foreign country, subject, however, to certain modifications arising from the different currencies employed in trading. No new book-keeping principles are involved; the difference arises from currency fluctuations.

Clearly, it is impracticable that the whole of the Branch books should be kept at the Head Office; the Branch must keep its own books. Head Office treats its branches as debtors for all remittances in cash or goods, and the Branches respond by treating H.O. as a creditor. The method already explained whereby Branch Profits are brought into the H.O. books by means of a debit to the Branch Account also applies in principle.

The H.O. books must, of course, be kept at home in sterling to provide a sterling Trial Balance, and the Branch books must be kept abroad in the local currency in order to record details of the local trading. The transfers of value continually passing between H.O. and Branch are recorded in a Branch Account kept in the H.O. books, and complemented in a H.O. Account kept in local currency in the books of the Branch.

Book-keeping Methods.—There are three methods of recording transactions with foreign branches:—

(1) Assume for book-keeping purposes that a stated sum in foreign currency is the exact equivalent of a stated sum in sterling, for example, that $4·866 = £1. This method is employed when the currency is stable, and it is usual to take, as in the illustration, the mint par of exchange between the currencies, or the nearest round figure to the mint par.

(2) Allow the H.O. books and the Branch books to run independently, and, at balancing periods, when the figures are combined, convert the items in the foreign Trial Balance into sterling at equitable rates, having regard to their nature and the circumstances of their origin. This method is employed when the currency of the foreign branch is unstable.

(3) Although the exchange rate between the home and the foreign currency fluctuates widely, assume an artificial parity as in (1), and make the periodical adjustments in the books required to correct the excess or defect in the valuations arising from the assumption.

(1) STABLE EXCHANGE.

Here the fixed conversion rate assumed for all inter-house transactions will obviate the futile labour that would be involved if every transaction between H.O. and the Branches were worked out at the actual exchange rate ruling on the various dates.

Mode of Procedure.—The Branch will keep its H.O. Account in local currency. Memorandum columns will be provided on either side of this account to accommodate the sterling equivalent of each item therein, converted at the rate adopted. The H.O. will keep its accounts in sterling and may, if it thinks advisable (but this is often unnecessary) make similar provision for the insertion on both sides of the Foreign Branch Account of the foreign equivalent of each item appearing therein. Thus the Branch Account in the H.O. Ledger, and the H.O. Account in the Branch Ledger, will be exact counterparts of each other, both as regards their sterling and their local-currency columns, and if the Branch Trial Balance as a whole is converted into sterling at the agreed rate of exchange, it can be amalgamated with the H.O. Trial Balance in exactly the same way as would be followed if the Branch were a home and not a foreign one. The employment of a fixed rate of exchange links the books at home kept in sterling with the books abroad kept in local currency, and the harmony of the two sets of books (allowing for mere matters of arithmetic) is complete.

Moreover, any balance appearing in the Branch books can be written off these books, and transferred to the H.O. books through the reciprocal account kept between the two houses, always, of course, at the agreed rate of exchange. Thus, when the Branch has ascertained its profits, it can transfer them, in local currency, to the credit of the H.O. Account, and the H.O. can pass an entry through its own books, at the agreed rate of exchange, for the sterling equivalent of the profit, debiting the Branch, and crediting its own General Profit and Loss Account.

Profit or Loss on Exchange Account.—Since the harmony of the home and foreign books proceeds from the conversion of all inter-house transactions at the one invariable rate of exchange, it follows that any transactions effected at rates other than the rate adopted must, nevertheless, be put through the reciprocal account at the adopted and not at the actual rate, and that the difference between the two rates must be written off to a Profit or Loss on Exchange Account, or Difference in Exchange Account.

Thus, a London House, working on the basis of the fixed rate of £1 = Mks. 20, remits Mks. 100,000 to its Berlin Office, at the rate of £1 = Mks. 20·42, costing £4,897 3*s*. 2*d*. It must therefore debit its Berlin Office with Mks. 100,000 (at £1 = Mks. 20) = £5,000, and credit the difference of £102 16*s*. 10*d*. to Profit and Loss on Exchange Account. Similarly, if the Berlin Office remits London £2,000 at the rate of £1 = Mks. 20·45, costing Mks. 40,900, it must either debit London with Mks. 40,000 (*i.e.* at the fixed rate) and write off the difference of Mks. 900 to Profit and Loss on Exchange Account, or, alternatively, it must debit London with the sterling equivalent of Mks. 40,900 at the fixed rate = £2,045, and London must, when responding to the entry, debit £45 to Profit and Loss on Exchange Account as representing the difference between the sterling equivalent and £2,000.

Any credit balance on the Profit and Loss on Exchange Account is better carried forward as a reserve against future differences and fluctuations. Any debit balance should be written off at once.

(2) FLUCTUATING EXCHANGE.

When a business house has a branch or branches in a country whose monetary unit fluctuates in its sterling value, the home office, in addition to being subject to the ordinary vicissitudes inseparable from the endeavour to earn a local trading profit, is always faced with uncertainty as to the extent to which the local profit, when earned, will be affected by exchange relations between the two countries.

Ordinary Book-keeping Principles Apply.—In the main, the ordinary routine of inter-house book-keeping applies, whether the Parent House and its Branch are located in the same, or in different countries; or, if the Branch is a foreign one, whether the local currency is stable or unstable. The Parent House keeps its books in sterling, and treats its Branch as a debtor for all remittances in money or kind, and the Branch keeps its accounts in the currency of its domicile, *i.e.*

either in sterling, or a stable or fluctuating foreign currency, and treats the H.O. as a creditor for all credits or remittances received.

It has been shown above that where the exchange between two countries is stable a fixed conversion rate is used, and the Branch and H.O. books form the two halves of a single set of books, connected throughout the year by means of the reciprocal accounts. But when the local currency of the Branch is unstable, the H.O. and Branch books must, for the most part, be kept independently, and they cannot be combined with the H.O. books for the purpose of preparing the accounts of the whole undertaking until they have been subjected to revision in the light of exchange values.

Remittances Account.—It has already been mentioned that the H.O., in all cases, opens a ledger account for each individual foreign branch, to which remittances to or from the branch are either debited or credited as the case may require. But when dealing with fluctuating currencies, it is preferable to record remittances in a subsidiary Remittances Account, in order to relieve the main Branch Account of the cumbersome detail. If this method is adopted, all remittances will, in the first place, be posted to the Remittances Account, and the total of that account will subsequently be transferred to the Branch Account proper. Both the Remittances and the Branch Accounts will be provided with currency and sterling columns, and the exact amount of currency will be placed against each item. The debit balance appearing in the Branch Account in the H.O. books, will, in these circumstances, represent the amount invested by the H.O. in the Branch business, and any profits that may be made by the Branch will represent the return on the investment.

Book-keeping by the Branch.—The foreign branch will conduct its book-keeping independently throughout, in the local currency. Like the H.O., it will open a Remittances Account, and also a H.O. Account, keeping both in sterling and in local currency. Allowing for the differences in dates, these accounts will be exact counterparts of the H.O. accounts. At the end of a trading period, the accounts must be reconciled by adjustments for items in course of transit, as already explained in connection with Branch and H.O. Accounts in general.

Conversion of Foreign Branch Account.—When the reciprocal H.O. and Branch Accounts have been reconciled as explained above, the Branch Trial Balance in local currency must be converted by the H.O. into a sterling Trial Balance, in order that it may be incorporated with the H.O. Trial Balance, and thus form a combined statement for the whole undertaking. But the Branch Trial Balance cannot be converted into sterling at a uniform fixed rate, as it could if the exchange were stable. Each item must be considered on its merits, and must be converted at such a rate of exchange as, in the circumstances, is most equitable. As a consequence of this treatment, the Branch Trial Balance, when converted, will not show equal debit and credit sterling totals. When all the items have been converted into sterling, the two sides are bound to disagree, and to effect the necessary agreement the difference must be inserted as a profit or a loss on exchange as the case may require.

Rules for Conversion.—The rules for converting the various items in the Branch Trial Balance are as follows:—

(1) *Fixed assets must be valued at the rate which ruled at the time of their purchase or when funds were specially remitted to pay for them.* The reason for this is that the assets are acquired for permanent use by the Branch, and not for sale, and once the rate is determined it should, in ordinary circumstances, remain unaltered.

Additions to fixed assets made during the trading period, and also long-term mortgages, or other fixed liabilities, should be converted on the same principle. Capital expenditure, spread over a period, may be converted en bloc *at the average ruling rate for the period.*

In some cases the Fixed Assets Accounts are transferred from the Branch to the H.O. books, through the reciprocal accounts. In such cases they no longer appear in the Branch Trial Balance. Frequently this is a wise proceeding, since it permits questions of depreciation to be dealt with more conveniently. The transfer must be made on the principles mentioned above. It must be understood that any depreciation which it may be necessary to make is a separate matter, and must be treated separately. If the depreciation is on a percentage basis, and the Asset Accounts are kept in the Branch books, the rate of conversion for the depreciation (written off in the Branch books) must be the same as that employed for the asset itself.

(2) *Current assets and liabilities, held or incurred for realisation, or payment in ready money, must be converted at the rate ruling on the last day of each trading period, just as though they had actually been realised or paid at that date.*

(3) *Profit and Loss balances, or the single balance of the Profit and Loss Account, where that alone is shown, should be converted at rates closely approximate to those ruling when the profits or losses arose.*

In practice, the average rate for the period is usually employed for conversion of the Profit and Loss balance, on the assumption that profits or losses have accrued equally throughout the period. The average rate is obtained by adding together the rates for, say, the first day of each month comprised in the period, and dividing the total by the number of days taken into average.

(4) *Remittances between H.O. and branch will already have been entered in both sets of books, and the cost in sterling of all remittances to the branch, as well as the proceeds in sterling of all remittances from the branch, will appear in the form of actual entries in the H.O. books. All that is necessary therefore at the end of the period is to convert the total of the remittances in the branch trial balance to a sterling figure equal to the actual sterling total in the H.O. books.*

It has already been stated that the sterling Trial Balance resulting from these various conversions will fail to agree until it has been adjusted by debiting or crediting the difference as profit or loss on exchange as the case may require. But since the profit or loss on exchange arises mainly in connection with the current assets and liabilities, it is essential, if a loss has occurred, to charge it against current revenue. If a profit on exchange is shown, it is doubtless permissible to carry it to the credit of current revenue, but it is more prudent to place it to the credit of a Reserve for Exchange Fluctuations, in order to provide for possible future losses.

The following example illustrates the principles enunciated above:—

Illustration.—From the following Trial Balances prepare the Balance Sheet of the Nictheroy Agency and Trading Company, Ltd.

RIO DE JANEIRO TRIAL BALANCE, DECEMBER 31, 19...

	Dr.	Cr.
	Milreis.	Milreis.
Cash in hand	1,500.000	
Cash at London and South American Bank, Ltd.	15,075.000	
Sundry Debtors	75,390.000	
Stock on hand	60,466.500	
Sundry Creditors		32,590.400
Land and Buildings	13,241.200	
Plant and Machinery	1,141.300	
Furniture and Fittings	1,011.200	
London Office Account :—		
Balance, January 1, 19... = £6,250		100,000.000
Remittances during the year = £1,580 2*s.* 6*d.*		25,000.000
Profit and Loss Account (Balance)		10,234.800
	Ms. 167,825.200	Ms. 167,825.200

LONDON TRIAL BALANCE, DECEMBER 31, 19...

	Dr.			Cr.		
	£	*s.*	*d.*	£	*s.*	*d.*
Share Capital				4,000	0	0
Sundry Creditors				4,198	4	6
Sundry Debtors	200	0	0			
Cash at Bank	168	2	0			
Rio de Janeiro Office Account, January 1, 19..., Ms. 100,000	6,250	0	0			
Rio de Janeiro Office Remittances during the year, Ms. 25,000	1,580	2	6			
	£8,198	4	6	£8,198	4	6

The rate of exchange may be assumed to have been as follows: At December 31, 19..., 16*d.* per milreis; average rate for 19..., 15½*d.* per milreis. The Land, Buildings, Plant, Machinery, Fixtures, and Fittings were bought when the rate of exchange was 15*d.* per milreis. Any profit on exchange is to be placed to a Reserve for Exchange Fluctuations Account.

Foreign Branch Ledger at Head Office.—In some undertakings a duplicate of the General Ledger of each Branch is kept at the H.O. Whether this procedure is wise in any given case depends largely upon the distance between the H.O. and the Branch; the effectiveness of the control exercised by H.O.; the Branch book-keeping facilities,

RIO DE JANEIRO TRIAL BALANCE AT DECEMBER 31, 19..., CONVERTED INTO STERLING.

Rate at which Converted.		Dr.		Cr.		Dr.			Cr.		
		Ms.	Rs.	Ms.	Rs.	£	s.	d.	£	s.	d.
16*d.*	Cash in hand	1,500	000			100	0	0			
16*d.*	Cash at London and Brazilian Bank	15,075	000			1,005	0	0			
16*d.*	Sundry Debtors	75,390	000			5,026	0	0			
16*d.*	Stock in hand	60,466	500			4,031	2	0			
16*d.*	Sundry Creditors			32,590	400				2,172	13	11
15*d.*	Land and Buildings	13,241	200			827	11	6			
15*d.*	Plant and Machinery	1,141	300			71	6	7			
15*d.*	Furniture and Fittings	1,011	200			63	4	0			
Actual	London Office Account			125,000	000				7,830	2	6
15½*d.*	Profit and Loss Account			10,234	800				660	19	11
	Ms.	167,825	200	167,825	200	£11,124	4	1	£10,663	16	4
	Profit on Exchange								460	7	9
						£11,124	4	1	£11,124	4	1

BALANCE SHEET AT DECEMBER 31, 19...

		£	s.	d.			£	s.	d.
Share Capital		4,000	0	0	Cash in hand and at Bank :—				
Sundry Creditors :—					London	£168 2 0			
London	£4,198 4 6				Rio	1,105 0 0			
Rio	2,272 13 11						1,273	2	0
		6,370	18	5	Sundry Debtors :—				
Profit and Loss Account		660	19	11	London	200 0 0			
Reserve against Exchange Fluctuations		460	7	9	Rio	5,026 0 0			
							5,226	0	0
					Stock on hand, Rio		4,031	2	0
					Land and Buildings, Rio		827	11	6
					Plant and Machinery, Rio		71	6	7
					Furniture and Fittings, Rio		63	4	0
		£11,492	6	1			£11,492	6	1

and other similar considerations. When a duplicate of the Branch Ledger is kept at the H.O., it is chiefly in total form, and involves, of course, the despatch by the Branch of summarised duplicates of its Cash Book, and its Purchases, Sales, and other journals. The keeping of a duplicate Branch Ledger by the H.O. affords a ready means of controlling the Branch, but it must be kept complete and up to date, and wholly in currency, as it would be by the Branch itself. It ranks only as a memorandum ledger, and forms no part of the H.O. accounting system. Such a ledger can, of course, be kept for any Branch, no matter what the local exchange conditions may be.

(3) FLUCTUATING EXCHANGE ASSUMED TO BE STABLE.

In some cases it is convenient, even though the exchange is unstable, to assume a fixed rate, and to conduct the book-keeping on that assumption, in the way already described as applicable to a stable exchange. This method does not always give such exact results as would be obtained by treating the foreign currency for what it is, viz. unstable, but provided periodical revaluations are made, should the actual exchange rate greatly differ from the rate assumed, it furnishes in many cases a fair working result.

By this method all transfers of funds or credits between H.O. and the Branches are passed through the Remittances Account in the H.O. books at the fixed rate adopted, any difference between the adopted and the actual cost or proceeds of any particular item being debited or credited as the case may require, to Profit or Loss on Exchange Account. The balance of the latter account needs specially conservative treatment.

Treatment of Balance of Profit and Loss on Exchange Account.—Reference should be made as far as possible to the particular transactions between the H.O. and Branch which gave rise to the nominal profit or loss on exchange in order that it may be apportioned equitably over the transactions. For example, nominal profit on exchange arising from remittances abroad to pay for the goods traded in, or to meet ordinary working expenses, could be added to the gross or net trading profit remitted from the Branch at the end of the trading period; or, alternatively, applied to the reduction of the debits which appear in the Trading or Profit and Loss Account. Conversely, if the profit arises from remittances to defray capital expenditure, it should go to reduce such expenditure, and must not be used in relief of revenue charges. Nominal losses on exchange require like, but converse, treatment. Concurrently, the general course of the exchange must be watched, and the fixed rate adopted for book-keeping purposes must be revised in case of need.

Branch Ledger at Head Office.—When, in dealing with an unstable exchange, the adoption of a fixed rate is convenient, it is often possible, by keeping at the H.O. a local Currency Ledger for Branch transactions, to relieve the local manager from the necessity of sending to the H.O. anything more elaborate than monthly cash

The Kintrang Gold Concessions', Ltd.

MANAGER'S LOCAL CASH ACCOUNT FOR THE MONTH OF DECEMBER, 19...

Receipts.									Payments.								
Date.	From whom received.	From what account received.	Currency.		Folio.				Date.	To whom paid.	For what account paid.	Currency.		Folio.			
19...			$	c.		£	s.	d.	19...			$	c.		£	s.	d.
Dec. 1	Balance from last month		5,000	00					Dec. 5	C. Brown	Chemist's Salary for November	250	00				
„ 5	Bank of Singapore	Sales of Gold	5,125	00					„ 15	Cash, to Manager	Wages for fortnight ended 14th per wages sheets enclosed	2,010	00				
„ 11	Bank of Singapore	Sales of Gold	374	00					„ 17	Kay Song & Co.	Stores purchased November 15th	650	00				
„ 26	Bank of Singapore	Sales of Gold	1,075	00					„ 18	Wee Kee & Co.	Stores purchased	15	00				
„ 31	Bank of Singapore	Remittance from London Office	5,000	00					„ 20	Manager	Petty Cash	50	00				
									„ 26	Government of Straits Settlements	Rents and dues on properties for year 19...	3,575	00				
									„ 30	Rawlings & Co.	Legal expenses	30	00				
									„ 31	Balance carried to next month (as certified by the Bank of Singapore)		9,994	00				
			$16,574	00								$16,574	00				

Certified as correct,
C. D., *Accountant.*
E. F., *Manager.*

Note.—Sterling columns are provided in the above for use in concerns which convert each item into sterling. The conversions may, in such case, be effected either at the local office or at the Head Office in London. Where, as is very often preferable, a local ledger is kept in London in currency only, the above account forms a loose-leaf cash account from which that ledger can be posted: it can also be used as a loose-leaf *sterling* local cash account for ledger-posting purposes if all items are converted into sterling in the columns provided.

SUMMARY OF STORES FOR THE MONTH OF DECEMBER, 19...

STORES RECEIVED.

	Currency.		Sterling.		
	$	c.	£	s.	d.
To Balance of Stores on hand at December 1, 19...	1,000	00	100	0	0
,, Stores received from London *ex* s.s. *India*	2,050	00	205	0	0
,, Stores purchases locally	2,110	00	211	0	0
	$5,160	00	£516	0	0

STORES ISSUED.

	Currency.		Sterling.		
	$	c.	£	s.	d.
By Stores returned to Settlers	15	00	1	10	0
,, Stores used during month:—					
(*a*) In obtaining output from mine (chargeable to Revenue Account)	2,990	00	299	0	0
(*b*) In mine development (chargeable as Capital Expenditure)	1,153	00	115	6	0
,, Balance of Stores on hand at close of month	1,002	00	100	4	0
	$5,160	00	£516	0	0

Certified as correct,
A. B., *Storekeeper.*
C. D., *Accountant.*
E. F., *Manager.*

Note. In the above illustration the dollar (worth 2*s.*) is used for the local currency. Where a local ledger is kept in London in local currency only, the columns for sterling are not necessary.

STORES ACCOUNT.

Dr.

		Rate per $.	£	s.	d.	$	c.
19... Jan. 1	To Stores received from London per s.s. *Ichanga*	10*d.*	100	0	0	2,400	00
,, 13	,, Stores purchased locally	11*d.*	2	5	10	50	00
Feb. 14	,, Stores received from London per s.s. *Oamaru*	10*d.*	200	0	0	4,800	00
Mar. 6	,, Stores received from London per s.s. *Changanga*	9*d.*	187	10	0	5,000	00
			£489	15	10	$12,250	00
19... April 1	To Balance brought down	1*s.*	£169	15	10	$3,395	83

Cr.

		Rate per $.	£	s.	d.	$	c.
19... Jan. 31	By Stores used for Capital Expenditure	10*d.*	50	0	0	1,200	00
,, 31	,, Stores issued for Revenue Expenditure	10*d.*	10	0	0	240	00
Feb. 28	,, Stores used for Capital Expenditure	10*d.*	60	0	0	1,440	00
Mar. 31	,, Stores used for Capital Expenditure	1*s.*	200	0	0	4,000	00
,, 31	,, Balance of Stores on hand	1*s.*	169	15	10	3,395	83
,, 31	,, Difference on currency columns transferred to Head Office Account					1,074	17
			£489	15	10	$12,250	00

and store returns, and similar simple statements. This is frequently an advantage, *e.g.* in the case of some mining and plantation companies, where there is no expert book-keeping staff at the local office. The Branch Ledger in local currency kept at the H.O. replaces the Ledger which the local office would otherwise have to keep. The method of amalgamating the H.O. Ledgers at balancing times follows the lines already laid down, the only difference being the domicile of the books.

In the case of mine accounts, the statements sent must show clearly the apportionments, as between current revenue and capital expenditure, of the cash and stores disbursed. In the case of stores, the return should take the form of a monthly debit and credit Summary showing the stores received and issued, and this must be duly balanced, and supported by detailed lists of the stores issued.

Plantation returns should give full details of the cash payments made and stores issued, and should show which of them relate to the crop account for the period, and which to future crops, or to capital expenditure.

The forms on pp. 632–634 illustrate the cash and stores accounts of a mine, the book-keeping in connection with which is done in London, on the basis of an assumed fixed rate of exchange. Plantation statements are sometimes drawn up on similar lines.

STORES ISSUED DURING THE MONTH OF DECEMBER, 19...

	Details.	Chargeable as Capital Expenditure.					Chargeable as Revenue Expenditure.				
		Currency.		Sterling.			Currency.		Sterling.		
19...		$	c.	£	s.	d.	$	c.	£	s.	d.
Dec. 1	Ropes and pitwood, Shift 1 . . .	15	20				1,045	90			
,, 5	Fuses, ropes, pitwood, and explosives, Shift 1	80	00				234	90			
,, 9	Fuses, ropes, pitwood, and explosives, Shift 2	342	00				121	10			
,, 11	Small tools and timber, per list, Shifts 1 and 2; ropes, sand, and pitwood, Shift 2	422	80				716	80			
,, 15	Small sundries, Shifts 1 and 2 . .	19	20				14	20			
,, 17	Small sundries for engine-house repairs.	5	60				100	00			
,, 25	Small sundries for engine-house repairs.	2	30				191	00			
,, 29	Oil and lubricants, engine-room . .	4	90				45	60			
,, 31	Fodder for ponies. Stable and engine-room supplies.	261	00				520	50			
	Totals, as given in summary for month.	$1,153	00	£115	6	0	$2,990	00	£299	0	0

Certified as correct,
A. B., *Storekeeper.*
C. D., *Accountant.*
E. F., *Manager.*

(4) TRANSACTIONS IN FOREIGN CURRENCY.

It is the British custom, where possible, to invoice goods in sterling, in order that the risk of profit or loss on exchange may fall upon the foreign customer. Competition, however, renders it more and more necessary to price and invoice goods in the customer's currency, and this necessity will probably grow more acute in the future, as competition in international trade increases. It is usual, in any case, to record sales in both currency and sterling, keeping special Foreign Sales Day Books, and Foreign Sales Ledgers, with double columns for this purpose. As each transaction is completed and paid for, the profit or loss on exchange is transferred to a special account. The following example will make the method clear:—

A of London invoices to B of New York the following:—

250 copies Library of Modern Thought	...	$1·25 each
250 copies Great Philosopher Series	...	$1·50 each

A used a fixed rate of $4·00 = £1 for conversion in his books.
B remitted a sight draft for the amount, which realised £172 2s.

FOREIGN SALES DAY BOOK.

	Ledger Folio	Currency	Sterling
		$ c.	£ s. d.
B, New York.			
250 copies Library of Modern Thought at $1.25 . . .		312 50	
250 copies Great Philosopher Series at $1.50 . . .		375 00	
		$687 50	£171 17 6

FOREIGN SALES LEDGER.

B. NEW YORK.

	$ c.	£	s. d.		$ c.	£	s. d.
To Sundries . .	687 50	171	17 6	By Cash . . .	687 50	172	2 0
,, Exchange Account (profit) . .			4 6				

(5) BRANCH CAPITAL EXPENDITURE—FLUCTUATING CURRENCY.

The student will understand that no actually realised differences in exchange exist in connection with foreign capital assets. Cautious finance, however, acknowledges the necessity of taking all factors into consideration when including foreign Branch figures in the Head Office Amalgamated Balance Sheet.

When the parent undertaking is engaged in constructing fixed assets in a foreign country where the currency fluctuates violently, it is often essential to keep the capital expenditure accounts in the H.O. books, and in sterling, and to transfer all such expenditure from the Branch to the H.O. books at short periodical intervals. In this way the Branch books are relieved of capital assets which, to a considerable extent, are protected from exchange fluctuations. The only balances then remaining on the Branch books are those representing current assets and liabilities, all of which, with the possible exception of the Materials Stock Account, are properly subject to the course of the exchange.

This plan necessitates no very special book-keeping features. A Capital Expenditure Account should be kept in local currency in the Branch books, to which all capital expenditure should be debited. Memorandum columns can be added to the account for inserting against each item either the actual exchange rate, or the sterling figures at the correct rate, or both.

At the end of the fixed interval, *e.g.* a month, the total debit shown in local currency in the Capital Expenditure Account kept in the Branch books should be converted, either at the actual rates used for its component items, or at the average of those rates, and transferred from that account to the debit of H.O. Account. A detailed statement of the total debit should be sent to H.O. for incorporation in its books, by means of a compensating credit entry in the Branch Account and a debit entry in the Capital Expenditure Account.

All conversions, including the charging back of capital expenditure, should be effected at rates as closely approximate as possible to the actual rates experienced, *i.e.* either at the actual rate or the averaged rate for the period. As provided for above, this will involve keeping notes of the actual exchange rates experienced.

Local Stores Account in Sterling.—It is sometimes found useful to insert against each item in the Stores and Materials Account, kept in local currency in the Branch ledger, its sterling equivalent. Stores can then be issued on the basis of sterling cost, and the monthly sterling total to be debited to H.O. is thus easily determined. The sterling figures are then the governing figures of the Stores Account, although the currency figures are necessarily employed to prepare the general Trial Balance of the Branch Ledger. Each receipt or purchase of stores is debited in sterling and in currency, the conversion rate being the rate ruling at the time of purchase. Each issue of stores, whether for local revenue expenditure or for capital expenditure on behalf of the H.O., is credited at its sterling cost, the local currency figures inserted being the equivalent of that cost at the rate of exchange on the day of issue. The sterling equivalent of stores issued for local revenue purposes is of no interest apart from the Stores Account, and such items find their way to the local Profit and Loss Account in currency only. When balancing the Stores Account, the sterling balance in the memorandum columns should be inserted and extended to the currency columns at the rate ruling on the last day of the period covered by the account. The sterling columns will thus agree, but the currency columns will show a difference on one side or the other, which must be written off, in currency only, to the debit or credit of H.O. Account, and is thus eliminated. The H.O. will respond to the entry in currency only, and since the currency columns of the H.O. books are of purely statistical interest, the adjustment of the difference is of no consequence.

EXAMINATION QUESTIONS.

1. What do you understand by "exchange" as between countries? Explain why the rate of exchange between two countries fluctuates from day to day. (*Chartered Accountants.*)

2. Describe briefly how international trade dealings are settled. (*Royal Society Arts.*)

3. H. E. Richardson & Co., of London, desire to remit £396 8s. 6*d.* to Hokoashi & Co., of Kobé, Japan. Describe three different methods of effecting the remittance which are open to Richardson & Co. (*Royal Society Arts.*)

4. Briefly explain the expression "par of exchange." (*Royal Society Arts.*)

5. Explain the mutual relations of the rates of discount ruling in any two given monetary centres and the rates of exchange between such centres. (*Chartered Institute Secretaries.*)

6. In consequence of the war, the rates of exchange all over the world have been subject to violent fluctuations. Explain a system whereby the comparison of the Annual Trading Account figures may be preserved and the item "Loss in Exchange" eliminated. (*Incorporated Accountants.*)

7. What is the "mint par of exchange"? Explain why it varies from the actual rate of exchange from time to time. (*Chartered Accountants.*)

8. The under-mentioned items, amongst others, appeared in *The Times* newspaper, in a column headed "Foreign Exchanges": Paris, 124–124⅛; New York, 4·87–4·87$\frac{1}{16}$. Interpret the meaning of the items quoted. (*Royal Society Arts.*)

9. How would you treat Foreign Branch Accounts in the following cases: (1) Where the rate of exchange is stable; (2) Where the rate of exchange is fluctuating? Explain on what basis you would incorporate the accounts of the Foreign Branch in the Head Office books, taking France as an example of a stable rate and Brazil as an example of a fluctuating one. (*Chartered Accountants.*)

10. Messrs. Pernet Ducher & Co., Ltd., London, have a branch office in a South American Republic, where the exchange fluctuations are considerable. The books of the Branch are kept in local currency only, and, at the close of each financial year, a Trial Balance, Profit and Loss Account and Balance Sheet are sent to the London office.

Briefly describe how you would amalgamate the Branch figures with those of the Head Office.

At what rates would you convert: (1) the Profit and Loss Account balance; (2) the Floating Assets; (3) the Fixed Assets; and (4) Remittances from London? (*London Chamber Commerce.*)

11. A London company, owning a mine in India, receives monthly cash statements, in Indian currency, from its local manager.

How would you pass these returns into the company's books and effect the necessary conversion into sterling?

Illustrate your answer by means of rulings of the book or books you would suggest, and enter therein six imaginary transactions. (*London Chamber Commerce.*)

12. A firm in London owns a business in Russia, and receives from the local manager a monthly statement of the transactions in Russian currency. How would you give effect to these transactions in the London books? Give rulings and three imaginary entries. (The approximate value of a Russian rouble = 100 kopecks is 2*s.* 1½*d.*)

13. A and B, carrying on business in London, had established a branch in New York on January 1, 1948, sending over Stock and Cash to the value of £1,000 as working capital. In the London books this appeared as "Capital, New York, £1,000." The equivalent in the New York books was $4,875. Profits were made in New York as follows: 1948, $2,762·43; 1949, $3,419·40; 1950, $4,350·15. As on December 31, 1950, the Branch was sold, the purchasers paying $10,000 for the goodwill, and taking over assets and liabilities

at book figures. They remitted the full amount by draft (the exchange being \$4·76½), and this had come to hand before the London accounts were closed for 1950. By arrangement, no New York profits had previously been brought into the London books. A and B, sharing profits five-eighths and three-eighths, make the necessary Journal entry in the London books to explain and close the transaction, as far as possible, as on December 31, 1950.

14. In preparing the Balance Sheet of a Bank having foreign branches, at what rates should the currency figures of the Balance Sheet and Profit and Loss Account be converted into sterling in the case: (*a*) of a Branch in France; (*b*) of a Branch in Brazil? How would you deal with any difference arising on conversion? (*Chartered Accountants.*)

15. You are auditing the accounts of a Liverpool merchant, with branch houses in New York, Valparaiso, and Lima, and owning freehold premises in each of those places, debited in the books of such branches respectively. The balance of assets over liabilities at each branch is translated at the rate of exchange ruling at the date on which the balance is taken, and treated as an asset in the Balance Sheet of the firm. Can you pass these entries? If not, state fully what adjustments would, in your opinion, be necessary. (*Chartered Accountants.*)

16. At what rates of exchange would you convert the following classes of balances, in the Trial Balance of the Brazilian Branch of a British limited company, for incorporation in the London books of the company at the end of a financial year? Give a reason for your answer in each case. (*a*) Fixed Assets; (*b*) Floating Assets and Current Liabilities; (*c*) Profit and Loss balance; (*d*) Remittances. (*Chartered Accountants.*)

17. **A. Brown & Co., London and Rio de Janeiro.**

RIO DE JANEIRO TRIAL BALANCE, DECEMBER 31.

	Dr. Milreis.	Cr. Milreis.
Freehold Land and Buildings (at January 1)	250,000	
Freehold Land and Buildings (additions during year)	11,000	
Stock of Goods on hand (December 31)	32,032	
Sundry Debtors	160,640	
Sundry Creditors		96,656
Bills Receivable	48,496	
Investment: Milreis 50,000 State of Amazonas Internal 5% Bonds, bought at 90	45,000	
Cash at London & Brazilian Bank	49,632	
Profit and Loss Account (balance, December 31)		60,672
Head Office Account (balance, January 1)		599,472
Remittance Account (£10,000 remitted to London)	160,000	
	Ms. 756,800	Ms. 756,800

From the above information prepare the Trial Balance for incorporation with that prepared from the London books.

The Freehold Land and Buildings are to be converted at the rate ruling when the assets were purchased (15¼*d.* per milreis), and the additions at the average rate ruling for the year (15½*d.*). The rate ruling at the close of the year was 15*d.* The Investment was bought as a permanent investment and is to be treated as having been bought at a time when the rate ruling was 16*d.* The equivalent of the Head Office Account balance (Ms. 599,472.000) as shown by the London books is £37,469 12*s.* 7*d.*

18. Prepare from the following figures a detailed statement, in a concise form, showing that the surplus assets abroad would be sufficient to provide for the excess liabilities (including Capital) in England:—

	England.			Mexico.	Burmah.		
	£	s.	d.	Dollars.	Rs.	a.	p.
Cash	1,075	2	10	10,400.75	1,35,990	14	6
Creditors	120,080	10	10	35,888.54	7,58,900	12	0
Debtors	13,822	10	4	16,952.12	1,97,886	12	2
Bills Receivable	17,128	10	6	—	3,75,000	15	10
Bills Payable	60,220	18	6	—	4,350	14	2
Investments	14,954	6	8	2,000.00	30,600	0	0
Shipments	70,426	16	11	5,541.02	1,05,989	10	0
Stock	440	14	6	160,072.25	6,45,763	4	8
Reserves	100,000	0	0	2,000.00	1,50,000	0	0
Share Capital	150,000	0	0	—	—		
Profit	3,857	13	10	—	—		
Payments in Advance	444	4	4	7,420.90	85,275	2	0
Properties	220,000	0	0	12,000.00	1,65,000	0	0
Advances to Natives	—			—	3,45,000	0	0

The dollar to be converted at 2*s.* and the rupee at 1*s.* 4*d.* (16 annas = 1 rupee, 12 pies = 1 anna). (*Chartered Accountants.*)

19. The Chemical Supply Company, Ltd., London, has branches at Calcutta and Bombay. The nominal Capital of the Company is £20,000, divided into 10,000 Ordinary and 10,000 Preference Shares of £1 each.

The accounts of the Indian branches are audited by a firm of chartered accountants, who supplied the following Balance Sheet as on June 30, 19...:—

LIABILITIES.			ASSETS.		
	Calcutta.	Bombay.		Calcutta.	Bombay.
	Rupees.	Rupees.		Rupees.	Rupees.
London Office	136,305	67,110	Stock	104,580	63,255
Creditors	700	1,780	Debtors	40,830	4,300
Bad Debts Reserve	2,550	1,400	Fittings and Furniture	6,350	950
Bombay Branch	1,950	—	Calcutta Branch	—	1,950
Profit for the year	12,280	8,275	Formation Expenses	—	1,250
			Cash in hand and at Bank	2,025	6,860
	Rs. 153,785	Rs. 78,565		Rs. 153,785	Rs. 78,565

For the purposes of conversion, the rupee may be taken at 1*s.* 4*d.*

The Head Office Trial Balance on June 30, 19..., was as follows:—

Credit Balances: Sales, £7,775; Bad Debts, £97; Preference Share Capital, £5,000; Sundry Creditors, £6,635; Commission Earned, £30; Ordinary Share Capital, £5,500; Bills Payable, £1,980.

Debit Balances: Purchases, £6,150; Freight Duty and Export Charges, £155; Wages and Salaries, £255; Trade Expenses, £60; Formation Expenses, £940; Postages, Telegrams, and Telephone, £56; Calcutta Branch, £9,387; Directors' Fees, £250; Cash in hand and at Bank, £650; Profit and Loss Account balance, June 30, £2,850; Stock, June 30, £40; Rent and Rates, £30; Stationery and Advertising, £75; Bank Interest and Charges, £22; Furniture and Fittings, £31; Bills Receivable, £45; Bombay Branch, £4,474; Commission Paid, £127; Sundry Debtors, £1,020.

On June 30 following the London Stock was £150 and the Stock of Stationery £45.

Cash in transit from Calcutta, £300.

Provide £170 for Commission Earned, and £120 for Bad Debts.

The Calcutta manager is entitled to a commission on the surplus profits of the Company in each year, after paying the Preference Share dividends, of £10 in respect of each 1% earned on the Ordinary Share Capital.

Prepare Trading and Profit and Loss Accounts for the year ended June 30, and Balance Sheet as on that date.

20. [illegible]

[illegible]

S[illegible]		
[illegible]		
[illegible]		
[illegible]		
[illegible]		
S[illegible]		
Profit and Loss [illegible]		

L[illegible]

Share Capital, [illegible]		[illegible]
South American Account [illegible]	[illegible]	
Cash at Bank	[illegible]	
Profit and Loss Account [illegible]		[illegible]
	[illegible]	[illegible]

Rate at April 1, 1s. 4[illegible] per milreis. Average rate, 1s. 3[illegible] per milreis. [illegible] at March 31 [illegible], 1s. 3[illegible] per milreis.

21. From the following Trial Balances prepare the Balance Sheet of the San Paulo Trading Syndicate, Ltd., as at June 30.

SANTOS TRIAL BALANCE, JUNE 30.

	Dr.	Cr.
	Milreis.	Milreis.
Cash at Bank of Brazil, Santos	[illegible]	
Stock of Goods on hand	[illegible]	
Sundry Debtors	[illegible]	
Bills Payable		[illegible]
Furniture and Fittings, balance at [illegible]	[illegible]	
Furniture and Fittings, additions from [illegible] to June 30	[illegible]	
Profit and Loss Account balance, being Net Profit for the half-year ended June 30		[illegible]
London Office Account [illegible]		[illegible]
	Ms. [illegible]	Ms. [illegible]

LONDON TRIAL BALANCE, JUNE 30.

	Dr.	Cr.
	£ s. d.	£ s. d.
Share Capital issued: [illegible] £1 Shares, 15s. per share paid		[illegible]
Cash at Bank	85 0 11	
Santos Office Account, Ms. [illegible] at actual remittance rates	7,7[illegible]7 3 9	
Profit and Loss Account balance brought forward from last year		352 4 [illegible]
	£7,852 4 8	£7,852 4 [illegible]

Current rate of exchange, December 31, 15*d.* per milreis. Current rate of exchange, June 30, 16½*d.* per milreis. Average rate for first half of year, 16*d.* per milreis.

Furniture and Fixtures on hand at December 31 were bought at 15*d.* per milreis; the additions during the first half of year were bought at 16*d.* per milreis.

22. From the subjoined Trial Balances, extracted from books kept respectively at the London and Paris offices of Reville & Co., Ltd., prepare the combined Balance Sheet of the undertaking as on December 31. A fixed rate of exchange of Fcs. 25·20 to the £ is employed in the business.

Reville & Co., Ltd.

LONDON (HEAD OFFICE) TRIAL BALANCE, DECEMBER 31.

	Dr. £	s.	d.	Cr. £	s.	d.
Share Capital				10,000	0	0
Stock of Goods on hand (December 31)	3,295	12	6			
Sundry Debtors	1,926	14	3			
Sundry Creditors				4,091	6	2
Freehold Premises	8,050	12	6			
Furniture, Fittings, and Fixtures	132	9	5			
Bills Receivable	450	0	0			
Cash at Bank	456	15	11			
Cash in hand	10	9	6			
Paris Branch Account (Fcs. 42,800 at 25.20)	1,698	8	3			
Profit and Loss Account (London), Net Profit for year				1,929	16	2
	£16,021	2	4	£16,021	2	4

PARIS BRANCH TRIAL BALANCE, DECEMBER 31.

	Dr. Francs.	Cr. Francs.
Sundry Debtors	40,806.05	
Sundry Creditors		28,000.00
Stock of Goods on hand (December 31)	12,500.00	
Furniture, Fittings, and Fixtures	2,000.00	
Bills Receivable	4,500.00	
Cash at Bank	13.097.50	
Insurance paid in advance (proportion unexpired)	98.00	
Cash in hand	1.926.00	
London Office Account (remittances received)		42,800.00
Profit and Loss Account balance, being Net Profit for the year		4.121.55
	Fcs. 74,921.55	Fcs. 74.921.55

23. W. P. & Co., Ltd., whose registered office is in London, have a Branch of their business in Paris. Both the London and Paris houses prepare their own Balance Sheets, and the following figures represent the Balance Sheets of the two houses on December 31. You are requested to combine the two accounts.

A fixed rate of exchange of 25·12 is used in the business.

LONDON BALANCE SHEET, DECEMBER 31, 19...

	£		£
Share Capital	25,000	Premises	10,000
Creditors	500	Debtors	8,495
Bank	5,000	Furniture	125
Paris Branch Account .	12,500	Bills	1,430
Profit and Loss Account .	2,495	Cash in hand	327
		Stock on hand	25,118
	£45,495		£45,495

PARIS BALANCE SHEET.

	Francs.		Francs.
Creditors	325,500.00	Debtors	8,500.50
Profit and Loss Account	3,876.00	Furniture, etc. . .	1,500.00
		Cash in hand . .	125.25
		London Office Account .	314,000.00
		Stock	5,250.25
	Fcs. 329,376.00		Fcs. 329,376.00

(*Incorporated Accountants.*)

24. A firm of London merchants received a Trial Balance from their Branch abroad—where the exchange is liable to considerable fluctuations—and incorporated the items in the London books at the rate of exchange ruling as on the date of the Trial Balance (December 31). The Trial Balance contained the following items: Premises, Plant, Sundry Creditors, Sundry Debtors, Stock, Cash in hand, London Office Account, and Profit and Loss Account.

Do you approve of the above proceeding? If not, how would you deal with the Branch Trial Balance in the London Books? (*Royal Society Arts.*)

CHAPTER XV

STORE-KEEPING AND COST ACCOUNTS

I. STORE-KEEPING.

Stores Records Essential.—Before discussing cost accounts, attention must be devoted to store-keeping records, since stores records should be kept, whether a proper costing system exists or not. The word " Stores " in this connection means the raw materials or other articles used in manufacturing goods or for carrying on a business; whereas " Stock " connotes finished goods held primarily for sale. These terms are frequently confused. Raw material is, of course, a relative term, for what is a finished article in one factory may be raw material in another. Although many businesses sell raw materials as well as finished articles, such raw materials are dealt with as stores, appropriate entries being made in the accounts for issues to the merchanting department. In every business it is essential to maintain a proper check upon those numerous items passing in and out of stock included under the vague title " General Stores." In a manufacturing business such records are vital to accurate pricing and invoicing of goods sold or work done, and slackness or inefficiency in keeping stores, and the records of their receipt and issue, will vitiate the results of any costing system.

An Efficient Store-keeping System.—The diversity of raw materials employed in different businesses makes it impossible to lay down hard-and-fast store-keeping rules or to submit stereotyped rulings capable of universal adoption. The system and rulings employed must be adapted to each particular business. Any attempt to make the business fit into a standard system is foredoomed to failure. All that can be attempted here is to outline the main principles applicable to store-keeping systems.

Ample floor space is a first essential to orderly and efficient store-keeping. Lack of proper control in the stores department is a certain source of trouble. Further, the store-keeper must be trustworthy and capable; and the system must work correlatively with the financial and costing records of the business, and must furnish an efficient check upon all goods entering and leaving store. Reliable store records will eliminate waste and extravagance, permit accurate estimating and prevent loss of interest on capital locked up in obsolete stock. In view of the reluctance of most manual workers to undertake clerical duties, the books should be as few and as simple as possible and the clerical work be reduced to a minimum. In that way, reliable results will be obtained more easily, since the store-keeper's time is usually and more properly occupied in the manual work of handling the goods in his charge. The actual stores ledgers should not be written up by the store-keeper, but by a member of the counting-house staff.

Incoming Goods.—On entering the works, all bales or bundles of goods should be checked against the copy of the order and the delivery note as regards number and weight by the gate-keeper, and entered in a Goods Inwards Book. This book should be regularly checked with the Store-keeper's Reports, the Delivery Notes, and the Invoices by a member of the counting-house staff. The store-keeper should check the contents of the packages for quality and quantity, and send the delivery note, duly initialled, with his report to the counting-house, where it should be checked with the original order and the invoice. Any goods below sample or specification or otherwise defective should be held on one side pending instructions from the counting-house or works manager. If they are to be returned, an authorisation should be sent to the store-keeper and a duplicate to the gate-keeper so that the latter can pass them out.

Bin Cards.—Goods received should be entered in the Stores Purchases Book as mentioned later. The materials in stock should be recorded on separate cards attached to each bin, sack, shelf, or locker, and the store-keeper will note on these cards particulars of all goods received into or withdrawn from stock. Where symbols are used to distinguish goods, these will also be recorded. Simple forms of Bin Cards are illustrated below.

BIN OR LOCKER CARD.

No. of Bin .... Where kept ....
Nature of Goods .... Limit : Maximum....................
Minimum ....

Symbol ....

Stock Received.			Given out on Requisitions.			Balance on Hand.
Date.	From whom.	Quantity or Weight.	Date.	Required for.	Quantity or Weight.	Quantity or Weight.

BIN OR LOCKER CARD.

.... DEPARTMENT.

Bin No. .... Description...................................

Stock Added Since.						Taken Out Since.					
Size.	No.	T.	C.	Q.	L.	Size.	No.	T.	C.	Q.	L.

Note.—These cards are suitable to attach to bins or lockers prior to stock-taking. This is particularly helpful for stock-taking purposes in cases where a count can take place a few days beforehand. On the actual day of stock-taking, individual checks or tests are made here and there, and the cards are collected and dealt with in the office.

In cases where quantities of special goods are purchased for specific jobs or contracts, against which they are earmarked, it is advisable to add a note to that effect in red or to enter them in an additional column provided for that purpose, so that the balance available for general issue may be clearly seen. Alternatively, special Bin Cards (with or without special Bins) may be provided. Neglect of these precautions may involve the business in considerable inconvenience, or even in direct loss, *e.g.* where lack of sufficient material causes a definite stoppage of progress, or delays it sufficiently to bring into operation a penalty clause in the contract.

As a general rule, the values of goods in store should not be shown on these cards, nor should they appear in any records kept by the store-keeper. The cards are totalled periodically, and checked and agreed by an independent clerk with the balances shown in the Stores Ledger. The total of the balances appearing on the Bin Cards should agree with the relevant balances in the Stores Ledger, and so should greatly facilitate stock-taking. Any discrepancies disclosed must be enquired into at once. Such enquiries are often tedious, but to delay investigation is fatal. A note should be made at these periodical inventories of any stocks which have not been operated upon for some time or which are deteriorating in value by storage. A serious waste of working capital occurs if it is allowed to remain locked up in obsolete stocks, and steps should be taken to realise the stocks at the best price obtainable. The " maximum " stock allowed for stores should, in respect of little-used stores, be reduced to more appropriate quantities, and the " minimum " stock for such stores may also be capable of reduction.

Receipt of Goods into Store.—When the stock of any particular material is running low (*i.e.* nearing the fixed " minimum ") the store-keeper must send a formal requisition—a Store-keeper's Requisition Form—to the ordering and buying department specifying the materials required. Frequently these requisitions have to be passed by the works manager before they go to the buying department. When the buying department has ordered the requisitioned goods, an advice note will be sent to the store-keeper informing him what goods he is to expect. The usual procedure is to make out all orders in triplicate books. One copy goes out as the actual order; a second goes to the store-keeper as a check upon the incoming goods, and the third remains on record in the order book for reference in case of need. In no circumstances should the store-keeper be allowed to order goods direct. Particulars of these requisitions should be recorded by the store-keeper in a Stores Requisition Book (*see* p. 649), and full particulars of the actual *quantities* of goods received should be recorded against the requisitions. To facilitate posting, the Goods Received Books should be kept in duplicate for alternate days. In some cases loose daily Goods Received Sheets are preferred for convenience in circulation.

It is not wise to hand the invoices for goods to the store-keeper, lest he be tempted to avoid the trouble of an independent count and assume that the invoiced quantities are correct. The invoices should be checked in the counting-house against the goods received records in

STORES PURCHASES BOOK.

Requisitions.				Goods Received.														
Date.	No. of Requisition.	Particulars.	Quantity.	Date of Delivery Order or Credit Slip.	Order No.	From whom Received.	Particulars.	Quantity.	Weight.				Price.	Amount.			Folio.	No. of Bin Card.
									T.	C.	Q.	L.		£	s.	d.		

the Stores Purchases Book, and deficiencies should be reported at once to the suppliers of the goods.

In some instances the store-keeper will receive goods that he has not requisitioned, the buying department having directly ordered goods for particular jobs or contracts. These goods will be recorded by the store-keeper in the Store Purchases Book, and their arrival be notified to the buying department.

Where partially or completely manufactured goods are received into store from the works, they may conveniently be recorded in a special Stores Received Book ruled similarly to the Stores Purchases Book.

Issue of Goods from Store.—It must be a rigidly enforced rule that no goods shall be allowed to leave the store except against a properly completed Requisition Form, in the same way that no goods should be allowed to leave the works except against a properly authenticated Pass-Out Form. Each foreman should be supplied with a carbon copy book of requisition forms in duplicate or triplicate, one copy being retained in the book, one going to the store, and (where considered advisable) one being sent direct to the counting-house. Similar books should be issued for credit slips. These requisition forms require careful scrutiny, as the accuracy of the eventual charging up of the job or contract depends upon the care with which the particulars are recorded. The requisitions must be signed by the foreman requiring the goods, and must state the date, the quantity required, and the order number of the job or contract for which the stores are to be used. If the stores are taken by a messenger, he should sign or indorse the requisition form. Adequate control must be exercised to prevent continual ordering of small quantities with the attendant expense of increased recording and waste of time on small issues, on the one hand, and over-ordering with increased risk of carelessness and spoilage on the other hand. At the close of each day or shift, the requisition forms should be handed to the costing clerks.

At times there is bound to be a quantity of stores remaining over from a job or contract. Particulars of such surpluses should be entered by the foreman on a Credit Slip or Materials Return Note and the stores returned to the store-keeper, who must treat them as an entirely fresh receipt of stores. In some cases it may not be convenient to return these "overs" to store. Where, for example, a builder is erecting houses on a distant site, it would be futile to return the bricks, cement, sand, etc., left over from one house, and then to reissue the material from store, possibly, to another house in course of erection on a contiguous site. To meet such cases a Transfer Slip, or Materials Transfer Slip, similar to the requisition and credit slips, must be made out by the foreman transferring the stores and be signed by him, by the receiving foreman, and by the site superintendent, and sent to the counting-house, a copy being retained as before. Supervision over transfers of this kind is essential, otherwise certain jobs will gain at the expense of others, and both costs and future estimates will be vitiated. These transfers do not concern the store-keeper, but are handed to the costing clerks for transfer from one job or contract to the other.

STORES LEDGER.

(Left hand Page.)

Nature of Goods .... No. of Rack ....

RECEIVED INTO STOCK.

Date.	Order No.	Folio.	From whom Supplied.	No. of Invoice or Credit Slip.	Quantity.	Weight.				Price per Unit.	Amount.		
						T.	C.	Q.	L.		£	s.	d.

STORES LEDGER.

(Right hand Page.)

Maximum Stock .... Minimum Stock ....

ISSUED OUT OF STOCK.

Date.	Requisition No.	Folio.	To whom Issued.	Quantity.	Weight.				Price per Unit.	Amount.			Balance in Hand (Quantity or Weight).
					T.	C.	Q.	L.		£	s.	d.	

General Note re Rulings. It will be seen that columns for "Amounts," etc., have been included in certain of the rulings recommended. These columns should not be filled in by the storekeeper, but by the counting house staff. It is an advantage to keep these records on the loose-leaf or card system, the storekeeper being handed the sheets necessary for each day, and being made responsible for their return daily to the counting house whether used or not.

REQUISITION FORM.

Stores Requisition.

No. ....

Date .... 19...

Goods required for .... (job or contract number).

Counterfoil.	Particulars.	Quantity.	Weight.				Price per Unit.	Amount.			Reference Folio.
			T.	C.	Q.	L.		£	s.	d.	
Requisition No. .... Date .... No. of Order .... (Details of Materials demanded) Initials	Demanded by .... Supplied by										

STORES ISSUED BOOK.

Date.	No. of Requisition.	To whom Issued.	Particulars.	Quantity.	Weight.				Price.	Amount.			S.L. Folio.
					T.	C.	Q.	L.		£	s.	d.	

Consumable stores or materials issued for general use (*e.g.* oil, waste, grease, repair stores, etc.) should be recorded as issued to the department concerned, and, if needed for machine repairs, the shop number of the machine should be entered, so that the proper manufacturing charge may eventually be formulated. Requisition forms for stores for general use are frequently printed on coloured paper.

All goods issued should be recorded in the Stores Issued Book, from which postings to the Stores Ledger are effected. It may be convenient to duplicate this book under various headings to avoid subsequent analysis; and, where the work is heavy, separate books for alternate days or weeks will help to keep the work up to date. Materials purchased for special contracts or jobs may, if desired, be recorded in a separate book.

The Stores Ledger.—This ledger records the whole movement of stores both inwards and outwards, and the balances extracted from it at any time should represent the actual quantities and values of the stores in hand. This ledger should be kept in the counting-house by a special clerk (or clerks), whose duty it will be to analyse the invoices, requisitions, credit slips, transfer slips, etc., and to post the Stores Ledger. Briefly put, the accounts in the Stores Ledger are written up as follows: All goods going into store are *debited* from the Goods Inward Book (Stores Received Book), the credit slips, and transfer slips. All goods going out of store are *credited* in accordance with the details shown on the Requisition Forms. The above debits and credits will supply *quantities* or *weights* only. The *values* will be obtained from the invoices or from the cost prices adjusted by the Costing Department, as explained later. The balances shown on the Stores Ledger should agree with and afford a check upon those on the Bin Cards and also a check upon the *financial values*. A separate ledger opening must be provided for each item of sufficient importance to warrant a separate account. Small items, when numerous, must be grouped with those of a like kind. A note of the location of the bin or locker, and the maximum and minimum amounts of stock (in quantities) which are to be carried, should appear at the head of each account. When the minimum is reached, immediate notice must be given to the ordering department.

A "total account" should be built up for the Stores Ledger, or if there are several ledgers, for each ledger. When the individual invoices are debited to the appropriate class of store, they should be summarised and credited in total to the Total Account. The requisitions (less credit slips) should be debited in total to this account, so that the double entry may be completed at each stage and the balance of stores in hand seen at any time. Care must be exercised in compiling the figures, which, when accurately kept, are of great assistance to the ordering department, and at stock-taking, and at an internal check upon stores. The employment of the card or loose-leaf system greatly facilitates the compilation and the arrangement of store records, and is gaining in popularity.

A very important question that remains for discussion is the price or value to be placed upon stores for costing purposes. Differences of opinion exist upon this question, but the methods explained below will be found practical and in general use.

Methods of Arriving at Values for Stores Ledger Entries.—The values to be debited to each class of goods in store should, in the case of bought goods, be the invoice price less trade discount. In the case of goods partially or wholly manufactured in the works, cost price may be adopted, although, as will be discussed later, a comparative wholesale price, or other "loaded" value, is sometimes used. Pricing out issues of goods is rather more complicated. For costing records, all inward charges (*e.g.* carriage, freight, cartage, duty, etc.), must be taken as forming part of the cost of the goods for issue purposes, and this addition to invoice cost will operate to throw the ledgers out of balance, unless such inward charges are debited to the relative stores accounts or are subsequently adjusted. It is therefore advisable that this adjustment should be made where the stores ledgers are used in conjunction with a costing system, otherwise it is not so important, and the goods can be issued at the net invoice cost. If the prices of materials do not vary throughout the period under review, there is little difficulty in arriving at an accurate price per unit of issue, and in such cases the original cost price would be adhered to. In practice, however, it is usual for market prices to fluctuate from time to time, and it is necessary, therefore, to adjust the issue prices accordingly. In some cases monthly averages are taken as the basis for the ensuing month. Where issues are made in bulk, it is possible to use the original cost price of the oldest stock on hand, on the basis that the goods which came in first will be issued first—this tends to prevent the accumulation of obsolete stocks. Advocates of "real costs" contend that this is the only sound method. If an issue comprises goods bought at different times and prices, two issues prices, or an "equated" price, has to be arrived at. This method is more conservative—when an estimate has been based upon the cost of material in stock at the time when the tender was prepared—since, even if the price of raw materials rises before the contract is executed, the business has covered the necessary supply at a price which will ensure a profit. This eliminates the gambling element when buying materials. The proper pricing of goods is, of course, the work of the Costing Department, where a *Price Record Book* should be kept containing particulars of past and current prices.

A second method is to charge out the goods at the current market price at the time of issue. It will be clear that if stores are priced out at any other figure than actual cost, either a profit or a loss will be shown on the stores accounts, and this fact will complicate the reconciliation of the *values* in the stores accounts, and will increase the difficulty of agreement between the costing and financial records, if this achievement be desired. In many cases, however, this will not be regarded as a very serious objection provided *quantities* are agreed. This second method certainly tends to make competition more rational, as costs will be based on lines comparable with those of businesses which buy as they go.

When pricing out the issue of goods in comparatively small quantities, or goods which are not easily identified, the average-price method may be adopted. It must be pointed out, however, that this method involves more clerical labour, and is more liable to error, since every change in price involves a change in the average. This method is not suitable for the issue of the finished parts of goods, since they should be issued in the order in which they are made, and it is undesirable to introduce further variables into their cost.

Conservative manufacturers sometimes go to the extreme of issuing goods at the original purchase price of the highest priced stock; but this is not advisable, as it will generally mean either that estimates are too high to secure contracts or that complicated adjustments must be made in framing the estimates.

It must be emphasised that goods purchased for specific contracts or jobs should invariably be priced out at the actual cost price, irrespective of the prices used at the time for issuing similar goods to ordinary contracts, since the estimate was based on the cost of the specific goods in question.

Stock-taking.—Theoretically, if the store records are accurate, stock-taking could be dispensed with. The aggregate balances of the Bin Cards, after agreement with the balances of the Stores Ledger, should furnish the total stock in hand at any date. If a pepetual check is kept on the stock, as shown by the balances on the Bin Cards and Stores Ledger, it is possible that the total stock shown as being in hand may be more accurate than the figure arrived at by the usual stock-taking methods, especially if these methods are elastic, as they sometimes are! In practice, however, discrepancies will be disclosed by the Bin Cards due to deterioration of stores, waste in measuring, errors in recording, and the like. It is wiser, therefore, to make extensive tests of the actual contents of the bins or lockers before accepting the card records as correct.

II. COST ACCOUNTS.

There is no necessity in these days to emphasise the importance of cost accounts, either from the manufacturer's or the examinee's point of view. Present competitive conditions make it imperative that accurate and reliable accounts should be available showing not only the financial results of each trading period for a business as a whole, but also the extent to which each unit—be it article, job, contract, department, process, or service—that contributes to make up the aggregate turnover of the business is separately responsible for those results. Manufacturing businesses, in particular, have now, with few exceptions, devised costing systems that enable the management to determine with substantial accuracy the cost of every article manufactured, and, indeed, of every separate process incidental to their manufacture. The changed conditions and the disturbing price fluctuations that have hampered post-war manufacture have rendered pre-war costings useless for present-day purposes, and at the same time have made it both more difficult and more imperative to ascertain what the current costs of manufacture actually are.

It cannot be over-emphasised, however, that cost accounting is essentially the same in principle as ordinary accounting, except that it aims at "accounting for units." For that reason it is seldom practicable to incorporate the cost accounts in the general system of double-entry book-keeping, since to attempt to do so would necessarily involve the disappearance of many of the nominal account totals which are required for the preparation of the financial accounts at the end of the trading period. It is necessary, therefore, to instal a separate system of double-entry accounts working side by side and capable of approximate reconciliation with the financial books proper. Absolute exactitude is scarcely possible in the majority of cases, since the time and trouble necessary to allocate the multitude of small expenses incurred in any manufacture would defeat the desired object, as will be seen later.

Definition.—By cost accounting is meant a specialised application of the general principles of accounting in order to ascertain the cost of producing and marketing any unit of manufacture, or of carrying out any particular job or contract. By "cost" is meant all expenditure that can properly be allocated to the production of the unit, or to the job or contract undertaken.

Principles of Costing.—In the space available in a general textbook it is possible only to outline generally the main principles involved in the ascertainment of costs. But, because these principles are general, once they have been learned, they can be applied to any business, provided that due allowance is made for technical variations. Moreover, in many cases it is found in practice that no two businesses, even in the same trade, will require *exactly* the same system. Some differences in application are always necessary, because the precise lines of the costing system must be adapted to the business and not the business to the system. Again, from the examinee's point of view, nothing but a knowledge of general principles can in fairness be expected of him.

Advantages of Costing.—An intelligently planned costing system affords the following advantages:—

(1) It shows the actual cost of production of each unit of manufacture, or the cost of running each department of the business, thus enabling selling prices to be fixed with due regard to those costs. It provides an analysis and classification of costs, and other statistics, all of which will be of the greatest assistance when budgeting for future requirements, or deciding policy, or increasing production.

(2) It provides exact data for estimating and tendering, and enables the cost for similar jobs or repeat orders to be adjusted in accordance with known variations in current expenses and conditions, and so places competition on a rational basis.

(3) It enables comparisons to be made between one manufacturing period and another; between the costs of different methods of manu-

facture; and shows the variations in cost resulting from the employment of different kinds of material or classes of labour.

(4) It reveals the effect upon production of an increase in wages, or a reduction of working hours.

(5) It discloses weak points in the factory system, *e.g.* inefficient or extravagant processes, unremunerative branches, departments, or manufactured articles. Businesses have been ruined by large increases in turnover in one particular department or product, previously sold in relatively small quantities, but always at a loss that is hidden from view by high profits made in other departments, or on the other lines of goods.

(6) It affords a check on the use of material, stores, and labour; exposes waste of time and effort; prevents losses of material by theft, deterioration, etc.; shows up inefficient workmanship and incapable management; and suggests directions in which economy can be effected, and the plant and machinery be used to the utmost advantage.

(7) It shows the cost and value of work in progress.

(8) It provides valuable data for fixing methods of remunerating labour and for regulating buying; and finally

(9) Shows the return to the business for a given expenditure, the cost per unit to be added for new capital expenditure, and affords workable estimates of the probable effect of the introduction of new machinery and the like.

Systems of Cost Accounting.—The student who desires to specialise in the subject has a wide range of text-books at his command, most of them dealing with one or other of the systems in use as applied to a particular trade. The general student cannot, of course, be expected to be familiar with the requirements of particular trades, but he must be conversant with fundamental principles. Below are set out the usual "types" into which costing systems are grouped, but it must be noted that in any one business, several or all of the types may be used in different departments or processes, *e.g.* it may be possible and necessary to allocate all expenses in the first place to departments, and then in each department to employ another type or types, according to the stage of manufacture. The multitude of systems advocated is apt to confuse the student, and he is advised to confine himself in the first instance to general principles such as are here enunciated.

Terminal, Job, or Contract Costing.—This system is applicable where definite contracts are entered into (*e.g.* Engineering, Building, Contracting, etc.), each contract being costed to its conclusion by the careful analysis of every expense of material and labour, and the attachment of a proper proportion of the shop or works Oncost expenses. The cost is then comparable with the price received. If absolute accuracy were attainable, the aggregate for the whole of the accounts should agree with the Profit and Loss Account, but in practice there will always be a margin of error, from causes which will be mentioned later.

Single, or Output Costing.—This system is applicable where there is a natural or standard unit of output. The cost is arrived at by dividing the total cost for a period, or batch, etc., by the number of units produced. The system is suitable for Collieries, Mines, Breweries, Quarries, etc., the unit being per ton, per barrel, etc.

Process Costing.—This is applied to undertakings where materials are converted by passing through several stages of manufacture, usually giving more or less valuable by-products at various stages, *e.g.* Chemical Industries, Tanneries, Gas Works, etc.

Operating or Working Costing.—This system is applied where the product is a service rather than a manufactured article, and the ordinary books of account contain, in themselves, the data necessary for costing the unit concerned. Railways, Tramways, etc., are examples in point, the unit being per passenger or per car mile. The system is sometimes employed in the case of Gas and Electric Works, where the subsequent processing of by-products is not done in the works.

Multiple Costing.—This method is applicable " where a number of products are involved bearing little or no relation to one another in cost or selling price, and in which the manufacture is organised to a high degree of specialisation in parts." It is adaptable to the manufacture of Cycles, Boots, Small Tools, Furniture, Hosiery, Toys, etc., the parts of which are standardised to a high degree, involving constant and regular processes and repetition work. Each process or operation must be costed separately so as to arrive at the total cost for a given number of articles.

Departmental Costing.—This type has been left till last, since, in the majority of instances, as mentioned above, it is merely a preliminary allocation, from which the output of each department is costed by some other type. Where it is difficult or impossible to obtain units suitable for calculation (*e.g.* in Retail Stores), the department may be treated as a whole, and periodical comparisons can be made with prior periods and with similar departments.

It must be realised that to a great extent the above divisions are arbitrary, since the system must be fitted to the works or business.

Devising a System.—The first step towards the inauguration of a successful costing system (after having induced the manufacturer to agree to the organisation of his works so as to afford the necessary data) is to enlist the sympathies of the works manager and his staff. The usefulness and expense of the system are dependent upon the size and organisation of the business, and a knowledge of technical detail is essential to success. The accountant must collaborate with the technical staff, and familiarise himself with the processes of manufacture, and the routine from which the costing data must eventually be collected.

Costing Terms Defined.

(*a*) *Prime Cost* (*Flat Cost*).—This is made up of the materials, labour, and expenses directly chargeable to a unit, job, contract, or particular service.

(*b*) *Oncost.*—In all manufacturing businesses certain indirect expenditure is inevitable. This expenditure is known as Oncost. For example, the wages of store-keepers, time-keepers, clerks, supervision expenses, and the like have no direct relation to any particular job or process, and do not rise and fall uniformly with the output. Expenditure of this nature must, however, be allocated, as it necessarily enters into all estimates and costing results. Oncost, therefore, represents the proportion which each unit, job, contract, or particular service must bear of the indirect, overhead, fixed, or establishment charges that cannot be directly allocated to any definite item of production—in short, all the expenses of a business other than direct labour, materials, and expenses. These expenses are frequently divided into "Works Oncost" and "Office Oncost." The former comprises all overhead expenses up to the point when the unit leaves the factory; the latter comprises all subsequent expenses. Office Oncost, again, is sometimes divided as between selling and distributing. Broadly stated, the direct element of cost = Prime Cost, and the indirect element = Oncost.

(c) *Total (Gross Production) Cost.*—This is made up of Prime Cost + Oncost. *Selling Price* consists of Total Cost + Profit. *Job Costing* is simply a method of charging costs against individual jobs, *i.e.* direct labour and materials with an added percentage for Oncost. Few businesses are suitable for this system.

(d) *Direct Labour.*—Labour directly expended in producing a unit is termed *Direct Labour*; labour expended upon services general to the whole factory is termed *Indirect Labour.* The same subdivisions are frequently applied to materials and expenses.

(e) *Labour Hours.*—The aggregate number of hours worked by the whole labour staff.

Elements of Costs.—Broadly speaking, the costing system of any business is in reality an analysis of the Manufacturing or Trading and Profit and Loss Accounts. The debits appearing in these accounts resolve themselves into: (a) Items which are directly related to and chargeable against the articles manufactured (*i.e.* direct wages, materials, and expenses); (b) expenses that cannot be directly charged against the articles manufactured (*i.e.* indirect wages and expenses).

The student should realise that, at the best, cost accounts can only closely approximate to accuracy. They must of necessity include an element of estimate, and to the extent that they do they are less exact than the financial accounts.

So far as is practicable, all expense items are charged direct to the unit selected for costing purposes. It would be possible, with the expenditure of sufficient time and care in analysis, to allocate directly the majority of expenses, but the time and expense necessary for such meticulous analysis would rob the result of its value and far from justify the small margin of increased accuracy attained thereby. It is therefore better to speak of expenses as being "conveniently attachable."

A typical costing system will deal with:—

(a) Labour directly and conveniently attachable to the unit.
(b) Materials directly and conveniently attachable to the unit.

(*c*) Expenses and disbursements directly and conveniently attachable to the unit (*e.g.* travelling expenses of workmen engaged on a distant contract; plant bought for use on a specific job, etc.).

The above (*a*), (*b*), and (*c*) make up the *Prime Cost* of the unit.

(*d*) Expenses which cannot be directly and conveniently attached, *i.e.* Works and Office Oncosts.

Works Oncost is made up of indirect wages paid to cranemen, boys, store-keepers, yardmen, and other general labourers; rent of works; depreciation of machinery; expense of general stores (oil, waste, repairs, etc., and other factory expenses). This Works Oncost must be apportioned equitably over the units produced. Prime Cost plus Works Oncost is termed Works Cost, and if to this Works Cost we add a due percentage of the total office and administrative expenses (= Office Oncost) we then arrive at the Cost of Production. Cost of Production plus selling and delivery charges gives the total Cost of Output available for sale. Some authorities apply the terms "Cost of Production" or "Net Cost" as being synonymous with what is here termed "Works Cost," and use the term "Gross Cost" to signify "Works Cost" plus "Office Oncost."

Prime Cost will, of course, vary with the output, but Oncost is composed largely of charges that remain more or less fixed. The components of cost must now be dealt with in detail.

Labour.—The correct booking of time is a first essential of accurate costing. Wages may be paid on the time system (hourly, daily, weekly), or on the piece-work system, or the bonus system. Indirect labour is paid for almost invariably on a time basis. Piece-work is largely employed for direct labour. It may be "ordinary" (*i.e.* so much per unit completed), or "contract," *i.e.* a fixed price for a given job or quantity paid to a contracting foreman who acts for the men under him. Where the time system is in operation, each workman will be booked into and out of the works by a time-keeper or by one of the mechanical clocking-in machines (*e.g.* the Gledhill Time Recorders) now extensively used. The principle of these machines is that the workman inserts his numbered key, or card, in a clock, which records the time on a sheet or on the card, as the case may be. The older system of entering up each man's time in a time book is unreliable, cumbersome, and time-wasting.

Usually, only the times of entering and leaving the works will be recorded on the cards, although it is practicable and advisable in some cases to have additional clocks for each department, and for each large job or contract. In any case, where numerous jobs are passing through the works, it will be necessary for time sheets to be kept by the foreman for each man, or by each worker individually, to record the time spent and the work done, with the appropriate job number. The sheet made up for each man must be compared with his total time in the works as recorded by the clock, and any discrepancies must be immediately investigated.

The time sheets must be priced out at the worker's effective rate, and then analysed over the respective jobs, on a *Labour Abstract* (*Abstract of Wages*). So far as possible the wages will be attached to specific jobs, but there will be a certain proportion which cannot conveniently be so attached. This must be extended into the indirect wages column to be dealt with through the Oncost. Even where the piece-work system is in operation, it will still be necessary to keep time sheets for inside workers, as time enters directly into the cost. If one man takes twice as long to do a certain piece of work as his neighbour, a greater proportion of Oncost will be attachable, since the majority of the overhead charges are irrespective of output. A system which is growing in favour is to provide the men with a "job ticket" for each particular job. These tickets are collected daily, and a wages abstract is produced from them.

Bonus or *Premium Systems* are also growing in favour, but detailed explanations of these somewhat complicated systems cannot be entered into here. The principle of these systems is that a certain standard time is fixed for an operation, for which the worker is paid at the usual agreed rate. If the worker completes the work in less than the standard time, he is paid a percentage of the saving effected, or a premium equal to the percentage of time saved. These systems are more fully dealt with in *Accounting*, by the present author. In some instances a standard output for the works is fixed; if this output is exceeded, a *collective bonus* is paid to all the workers. In others a *High Wage Rate* is adopted and no bonus is paid, but the output must be maintained. Specimens of time sheets, etc., will be found in the author's *Accounting*. Wages paid under piece-work and bonus systems are summarised in the same manner as time wages.

The total of the Labour Abstract should be agreed with the pay-roll for the week, after which the postings may be made. Debits will be put through to the individual job accounts, to standing orders, etc., and to Indirect Wages Account, the credits being to Total Accounts appropriately named.

Materials.—It has already been pointed out that discrepancies will probably arise in accounting for materials, but they should be within narrow and ascertainable limits. The system of receipt and issue of goods recommended above gives all the necessary data for the costing records. The requisitions, credit slips, and transfer slips must be analysed out over jobs, as in the case of wages, on a *Materials Abstract*, and the postings entered up in a similar manner to that advised above for wages, including the Total Accounts. Materials bought for specific jobs should invariably pass through stores in the usual way. Indirect materials (*i.e.* materials which cannot be conveniently allocated to any specific job, such as oil, waste, etc.) must be dealt with in a similar manner to indirect wages.

Oncost.—In the case of Single Costs, the amount of Oncost attachable to each unit is readily arrived at by dividing the total indirect expenses of the period over the number of units produced, *e.g.* per barrel of beer, per ton of coal, etc. In other cases, Oncost is more difficult to distribute, and must to an extent be approximately estimated. The following is an outline of the more usual methods adopted:—

Percentage Method.—This can be employed where there is little variation in the rate of wages paid, and the machines used are of uniform cost and construction; and also in cases where the work does not vary, or varies only within narrow limits. The percentage may be calculated: (*a*) On wages in general, or at different rates for departments or classes of operation; (*b*) on materials; (*c*) on Prime Cost; or (*d*) on some differential basis combining two or more of the above methods according to the facts of the particular case, and the most constant factor in production. It will be clear that each case must be treated on its merits when we consider that two workmen, A and B, may be working side by side, each doing equally skilled work, but, while A is working on materials costing £100, B is working materials costing 10*s*. In circumstances of that kind, if the Oncost is allocated as a percentage on Prime Cost, and the wages earned on the jobs are in each case £5, it will be hopelessly inaccurate to load B's job with $\frac{5\frac{1}{2}}{105}$ as much Oncost as is attachable to A's job. In the case quoted, other factors being the same, the necessities would probably be met by the addition of a proper percentage on wages. To give effect to variations in the skill of workmen, efficiency hours may be taken for the allocation of the Oncost. The Prime Cost method is little used, and is applicable only in cases where the material worked is uniform throughout and forms the predominant element of cost.

Productive-Hour Method.—This is based upon a rate per hour of direct time. Where either the rate of wages or the nature of the work varies, a general or departmental rate may be adopted, based on the actual productive hours taken to execute a certain task or operation. Direct hand-labour hours are sometimes used for that class of work, and total direct labour for the balance of the costing. The total Oncost figure divided by the total direct-labour hours gives the Oncost rate per hour. The time sheets will give particulars of the man-hours worked.

Machine-Hour Method.—Under this method the cost of operating the machine is ascertained, and is embodied in a machine-hour rate based upon the time the machine is at work. This method is practically essential in the heavy trades, and must be employed where machinery is the predominant factor in production, and there is a wide difference in the cost of the machines employed and the power required to run them. Rates are calculated for each machine or group of machines. The expenses generally included in the machine-hour rate consist of rent for the space occupied by the machine, rates, insurance, depreciation, repairs, oil, cleaning materials, and all the like expenses of running the machine. The total of these expenses for the period the machine is to run, divided by the estimated running hours the machine is to work, will give the machine-hour rate. Needless to say, a period of average trading must be selected and not one of depression. The whole of the Oncost may not be fairly distributable where this method is employed, and some part of the charge may have to be apportioned on a different basis. The time sheets, again, will furnish particulars of the number of hours that each machine has run. The total expenditure on the machine, divided by the number of hours it has been worked, will give the machine-hour rate. The " expenditure on the machine " covers labour, power used, depreciation, repairs, etc., to which are sometimes added rent, rates, etc., based upon the space occupied by the machine.

Entries in the Cost Books.—The debits to the individual accounts in the cost books, by whatever method adopted, may be made weekly along with the labour debit, or they may be debited when the job has been completed. If the latter method is employed, care must be taken at balancing periods to make the adjustment for the Oncost on work in progress. The totals should be credited to a Total Account, which should, at regular and frequent intervals, be compared with the total of the actual expenses as recorded in the financial books, any discrepancies being investigated, and the rates adjusted at once, if necessary.

Office and Administrative Oncosts.—This charge is not usually apportioned on the above methods, but is computed as a percentage on Works Cost. Sometimes it is apportioned on the basis of turnover. However, the facts of each business must be considered separately, and the most suitable method adopted to meet those facts.

Primary (Direct) Allocations.—Since the object of allocating Oncost is to approximate costing to actual conditions, so far as possible, the necessity for approximation should be limited. Wherever possible, care should be taken to allocate expenses over the individual shops and departments, so that the limits of error should be reduced. Rent, rates, taxes, insurance, for example, may be apportioned on the basis of the number of square feet occupied, or on the cubic capacity of the space occupied; lighting, according to the number of points used; heating by cubic capacity; power by metered consumption, and so on. When all the expenses that can be ear-marked have been allocated to the respective shops or departments, there remain the general Oncost expenses, and these must be apportioned on the most suitable basis in the circumstances.

Care must be taken, in fixing rates, to make adjustments for expenses that do not attach equally over all departments or jobs in one department. There may, for example, be a preponderance of unskilled labour; in another, skilled men only may be employed, with a boy for odd jobs. As a general rule, unskilled workmen will be slower than skilled, and they will tend to spoil more materials and tools, and so require more supervision. More Oncost will, therefore, be attachable to unskilled than to skilled labour

It will be obvious that to cost a job or process *after* completion would be so to delay the costing as to render it useless. It is necessary, therefore, to base costing figures upon *past* experience, and to make adjustments from time to time in order to meet known alterations in conditions and circumstances.

The Cost Ledger.—This is the nominal ledger of the costing system, and it must be kept on complete double-entry principles. For this purpose Total Accounts are employed, as explained above; direct wages, purchases, stores, etc., being debited in detail to the particular cost account concerned, and credited to accounts headed Direct Wages, Direct Materials, Total Accounts, etc.

Total Accounts.—It remains to deal with these accounts at the end of the period. If Oncost has been debited periodically to individual job accounts, it will be seen, at the end of the accounting period, that the Oncost attachable to all work in progress has been apportioned. If Oncost is debited only to completed jobs, the appropriate Oncost attachable to all work in progress should be carried down on an Oncost Suspense Account.

The respective Total Accounts thus arrived at should now be compared with the actual expense accounts for the same items as shown in the financial books. If serious differences appear, they must be investigated, and, if necessary, adjusted to the Job Accounts. All differences, however small, should be noted in order to avoid similar discrepancies in the future, and, if necessary, the basis of allocating Oncost or the pricing out of materials and wages must be amended.

The Total Accounts have now fulfilled their function, and can be closed off to Cost Ledger Control Account. Completed jobs can also be closed off to this account. Under the first method there will then remain open only Uncompleted Job Accounts representing work in progress (Dr.), and the Cost Ledger Account (Cr.), which should agree; under the second method Uncompleted Job Accounts are stated only at prime cost. The addition of the Oncost Suspense Account gives the value of work in progress, and this should agree with the Cost Ledger Control Account balance.

Statistics can be prepared of the cost of completed jobs for comparisons and future use. Some authorities prefer to incorporate selling prices and profits or losses in the Cost Ledger, opening appropriate Control Accounts. In that case, the Control Accounts are closed off to a Manufacturing Account, which is reversed as compared with the ordinary financial account, so as to show the result of the period's manufacture as a whole. There seems little advantage in this method. It is a duplication of labour, and the Manufacturing Account should, as a general rule, show cost and not be concerned with marketing. All the useful information should be tabulated in a more readily accessible and comparable manner than is possible in the Cost Ledger, in which, perforce, there must be a separate opening for each job. This, however, is a question that must be decided according to personal predilections and the special requirements of the particular business.

BY-PRODUCTS.

In cases where manufacture involves a succession of processes, one of the chief accounting difficulties arises in connection with the by-products of manufacture. In the course of manufacturing the article, various substances, liquids, etc., may be produced for which, at least at first, no use can be found; and trouble and expense must be incurred in getting rid of them, thus adding to the cost of manufacturing the article. This problem was very acute, for example, in the earlier history of the manufacture of soap, certain of the by-products polluting the atmosphere to such an extent that they had to be buried immediately.

But time and experiment frequently find profitable use for these hitherto waste products, and so instead of being an additional expense they become marketable products, and reduce the actual cost of the main product. In the case of soap-making, already cited, an enterprising farmer found that the by-product made good manure. He took part of the output, until further experiment having showed that it had valuable chemical properties, chemists were found willing to pay ten times as much as the farmer for the by-product and to take the whole output. Here we have a by-product of intrinsic value, and, in some cases, of greater market value than the main product. It is clear that an attempt must be made to allocate costs equitably as between the main product and the by-product or products. Both main and by-products travel together up to the separation point, and it is the apportionment of the expenses up to this point that creates difficulty, since expenses incurred subsequent to separation can be attached to the particular product concerned.

In practice, it is found that manufacturers adopt different accounting methods for the costing of by-products. Sometimes only sales are recorded, and no attempt is made to separate the costs, or even to estimate them. It is impossible to tell by this "method" whether any profit is made on the by-products. Costs being unknown, there is no basis for fixing selling prices or for formulating manufacturing policy. But it must not be overlooked that in some small businesses little more than this can be done without incurring undue expense for clerical labour. A variation sometimes adopted is to debit the by-products with all expenses incurred after separation from the main product, proceeding otherwise in the same way. Under the first method no inventories are taken; under the second no stock sheets are prepared. In neither is any record kept of the by-product until it is sold, thus leaving a direct loophole for fraud.

Where nothing is done to the by-products after they have been separated from the main product, it is quite common, especially in small businesses, to take a daily inventory of the output, to prepare stock sheets, and to keep proper account of the movements of the by-products, crediting any realisations, as adjusted by stocks, to the main product, or to the main material entering into its manufacture. Many small gas-works, for example, credit the net realisations for unworked by-products to Coal Account. No "profit" is taken on such by-products, the aim being merely to "cost" the main product.

Method of Accounting.—The above loose and incomplete methods being dismissed, a workable system of separating the costing of main and by-products may now be described. As with all costing, the principles are fixed, but the application of the principles must be adjusted to the needs of the particular business. It has been said that

" all costing is approximate." That is a truism which it would be idle to attempt to refute. But there is no reason why the approximation should not be closely true to the actual facts. Under the system now suggested—it has been found to work well in practice—arbitrary values have to be assigned to the products at the point of separation one from the other, since, usually, it is impossible exactly to calculate the costs of each product. The points to be considered are: (*a*) how high a degree of accuracy is possible, and (*b*) the relative value of the products. The arbitrary values may be calculated on one of the following bases:—

(1) At current purchasing price for the article in the same state of manufacture, or at selling price less approximate profit.

(2) Where there is a common standard, on the basis of that standard, *e.g.* British Thermal Unit.

(3) Where the by-product has a market value, according to that value, less the profit which would be made if the residual were manufactured independently.

(4) Where none of the above methods is applicable, then by working back from the selling price, which is often the only thing in common to all the products. For example, where, in the manufacture of a solid, there is given off a gas and a liquid, it is usually impracticable to apportion on any basis other than price.

All expenses of material, labour, and oncost up to the point of separation of the products are debited to a joint account. Subsequent expenses are debited to appropriate accounts for main and by-products. From the selling prices must be deducted the estimated profits and subsequent expenses, thus arriving at the basic figures for the purpose of apportioning the " joint " expenses.

The calculation proceeds as follows:—

Joint Account: Expenses up to the point of separation.

	£	£
Material	500	
Labour	400	
Oncost	450	
		£1,350

Subsequent expenses:

	Main Product.	First By-Product.	Second By-Product.
	£	£	£
Material	100	80	90
Labour	120	70	85
Oncost	130	50	75
	£350	£200	£250
Selling prices	2,100	1,000	900
Deduct:			
Estimated Profit	50% 1,050	50% 500	33⅓% 300
	1,050	500	600
Subsequent expenses as above	350	200	250
Basis of apportionment of Joint Account	£700	£300	£350

The cost accounts will therefore appear as follows:—

	£	£	£	£
Process 1 (*Joint*).				
Material	500			
Labour	400			
Ontost	450			
	£1,350 *	700	300	350
Process 2.				
Material, etc. (detailed above)		350	200	250
TOTAL COST		£1,050	£500	£600

* These bases would also be used for subsequent apportionments, but would be recomputed from time to time.

It will be observed that no adjustment has been made for selling and administrative charges. If these are separately oncosted, they will be deducted at the same time as the estimated profit in arriving at the basic figures for apportionment. Where the rate of profit cannot be estimated for the main product, the calculations will be made for the by-products, their basic costs will be deducted from the joint expenses, and the cost of the main product can then easily be arrived at.

Unrealised Profits Taken in Process Costing.—Where a product is put through several processes, the finished article of one process becomes the raw material of the next. It then becomes necessary to decide at what price the transfers from process to process shall be made. If bare " cost " is taken, it is obvious that in all processes after the first it is impossible to ascertain whether it is profitable to manufacture the article or not. For this reason it is advisable, from process to process, to invoice out at the current wholesale price which would have to be paid for an article in a similar state of manufacture, or at a " loaded " price approximating thereto. Particularly is this the case where some of the raw material is purchased and not obtained from a prior process. An additional advantage derived from this system is that managers know only the results of their own department, and not those of the cumulative cost as a whole. This method involves a profit (or loss) being shown on each process. If a loss, steps must be taken to reduce the cost, otherwise it may be advisable to eliminate that particular process by selling at the previous process and buying for the subsequent one. Where this method is adopted, comparisons are possible with outside costs, and commission bases for the remuneration of managers can be determined. At stock-taking times, however, adjustments are necessary in order to eliminate the unrealised profits included in the closing stocks of finished and partly manufactured goods. So far as the goods have been sold, the profits have, of course, been realised, but a reserve must be built up for the whole of the unrealised profit included in the closing stocks; in subsequent years it will be necessary only to adjust for the increases or decreases in stock, in exactly similar manner to that employed when making a reserve for bad and doubtful debts. A simple example of the adjustment for the first year is appended:—

PROCESS 1.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Purchase of Raw Materials	600	0	0	By Process 2 (Wholesale price)	800	0	0
Less Closing Stock	200	0	0				
	400	0	0				
,, Labour and Oncost	300	0	0				
,, Profit (to Profit and Loss Account)	100	0	0				
	£800	0	0		£800	0	0

PROCESS 2.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Process 1	800	0	0	By Finished Goods	960	0	0
Less Stock	320	0	0				
	480	0	0				
,, Labour and Oncost	400	0	0				
,, Profit (to Profit and Loss Account)	80	0	0				
	£960	0	0		£960	0	0

FINISHED GOODS.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Process 2	960	0	0	By Trading Account	720	0	0
Less Stock	240	0	0				
	£720	0	0		£720	0	0

TRADING ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Finished Goods	720	0	0	By Sales	1,080	0	0
,, Apparent Gross Profit	360	0	0				
	£1,080	0	0		£1,080	0	0

PROFIT AND LOSS ACCOUNT.

Dr.	£	s.	d.	Cr.	£	s.	d.
To Reserves for unrealised Profits :—				By Apparent Gross Profit :—			
Process 2 (*a*)	40	0	0	Finished Goods	360	0	0
Finished Goods (*b*)	35	0	0	Process 1	100	0	0
				Process 2	80	0	0

(*a*) On the materials issued from Process 1 to Process 2 a profit of ⅛th was taken. There is still £320 of these goods in stock, on which an unrealised profit has been taken. This amounts to ⅛ of £320 = £40.

(*b*) The Profit taken in Process 2 is $\frac{1}{12}$.

Therefore the unrealised profit in Finished Goods *re* Process 2 is . . . . $\frac{240}{12} = 20$

Of the output (at invoice price) of Process 2, ½ is represented by output of Process 1, on which a profit of ⅛th has been taken, therefore the reserve *re* Process 1 is ⅛th of ½ of 240 15

£35

In subsequent periods, if the stock in any Process, etc., has increased, the reserve must be correspondingly increased. If the stock has decreased this means that the profit has been realised, and the reserve can be decreased.

In the Balance Sheet the Stocks will appear as follows:—

		£	£	£
Finished Goods		240		
Less Reserve for unrealised profit . .		35		
			205	
Raw Materials and Partly Manufactured Goods—				
Process 1		200		
Process 2	£320			
Less Reserve	40			
		280		
			480	
				685

If the market price should happen to be less in any case, a further reserve will be necessary. In practice, work in progress must also be adjusted.

COST SHEETS.

BREWERY COST SHEET.

Brewing No. .... Quality .... Date ....

Quantity.	Materials Used.	Stores Book Folio.	Price. £	s.	d.	£	s.	d.	Notes.
	Malt—								
	British								Barrels—
	Foreign								Brewed . .
	Sugar: Details . .								Racked . .
	Hops: Details . .								
	Preservatives: Details								
	Other materials—								Production—
	Details . . .								Barrels at a cost of per barrel.
	Duty								
	Less Grains sold .								
	Spent hops sold .								
	Sundries sold .								
						£			

Note.—After arriving at the cost of production, as shown in this section of the account, wages, water, fuel, and overhead charges would be added to complete the costing.

COST SHEETS—*continued.*

COST OF CONTRACTS IN HAND, DECEMBER 31, 19...

BUILDERS' ENGINEER.

No. of Contract.	Name of Contract.	Cost brought forward from last Cost Sheet.			Iron, Steel.			Scrap Iron, etc.			Stores Used.			Concrete, Bricks, Building Material.			Nuts, Bolts, Rivets.			Paints, Varnish, Grease.			Direct Wages.		
		£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.

COST OF CONTRACTS IN HAND, DECEMBER 31, 19...—*continued.*

Indirect Wages.			Travelling and Incidentals.			Fitters' Wages.			Carriage, Freight, Insurance.			Estimated Cost of Completing Contract.			Total Cost.			Contract Price.			Profit.			Loss.			Remarks.
£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	

Cost Sheets—*continued*

MOTOR-CARS.

Cost of Chassis.

	£	s.	d.	£	s.	d.
Purchases—						
Finished Parts						
Stores						
Wages—						
Machine-room						
Founders						
Erecting						
Sundry						
Works Oncost—						
Rent, Rates, etc.						
Fuel, Heating and Lighting						
Salaries and Indirect Wages						
Repairs, Depreciation, etc.						
Office Oncost—						
Office Rent, Rates, etc.						
Salaries						
Advertising						
Travellers' Salaries and Commission						
Discounts and Allowances						
	Total Cost .			£		

EXAMINATION QUESTIONS.

1. Carefully define the word "Stores" as employed in Costing systems. Describe in detail the method of charging out Stores, including raw material and finished parts, in Costing systems. Should the Stores be charged out at cost or at current market prices? In the latter case, how do you propose to reconcile your Stores Account in the Costing System with your Stock Account in your financial statement? (*Incorporated Accountants.*)

2. Give rulings of any books, or forms, which you recommend for the record of the above receipt and issue of stores, and make the necessary entries therein. (*London Chamber Commerce.*)

3. Select a manufacturing business with which you are familiar, and prepare a brief set of rules for the guidance of the store-keeper.

Submit rulings of *two only* of the books or documents you recommend. (*Chartered Accountants.*)

4. Sketch a Report showing the method that you would advise to stop an obvious leakage in the stock of any business with which you may be acquainted; such method to record the charge to and issue from Stores of Goods purchased.

5. Give a ruling of a Materials Abstract Book, suitable for employment in cases where purchases are made: (*a*) for specific jobs, (*b*) on Capital Account under three headings (Plant, Loose Tools and Sundries). (*Royal Society Arts.*)

6. Give suitable rulings for any three of the following: Order Book; Stores Issued Book; Stores Delivery Note; Stores Requisition Note; Stores Ledger Account; Departmental Wages Journal; Cost Ledger Account. (*Incorporated Accountants.*)

7. In charging out of Stores the basis of the pricing of issues is a contentious point. Give the relative merits of two methods. (*Incorporated Accountants.*)

8. Describe three different bases upon which wages are paid in manufacturing businesses, and submit a ruling for a weekly time sheet suitable for use in any business you may select. (*Royal Society Arts.*)

9. In a manufacturing business, where all labour is paid on a time basis, describe how you would: (*a*) check the time worked by the men, and (*b*) deal (for Costing purposes) with the wages paid.

Submit the ruling of the time sheet you would issue to the workmen. (*Royal Society Arts.*)

10. What is meant by a machine-hour rate, and how is it arrived at? (*Incorporated Accountants.*)

11. A manufacturer wishes to inaugurate a Costing system by means of which the Overhead or Oncost expenses may be presented as a percentage on the direct labour or on the total labour employed.

Discuss the principle involved and criticise the method suggested. (*Incorporated Accountants.*)

12. Briefly describe a manufacturing business with which you are familiar, and differentiate between the wages paid for: (*a*) Direct Labour; (*b*) Indirect Labour; and (*c*) Casual Labour. State how you would allocate the several classes of labour you define, when preparing the Costing records of the undertaking. (*Chartered Accountants.*)

13. Explain the difference between Works Oncost and Office Oncost. Indicate one or more ways in which such costs can be applied.

14. Give a suitable ruling for a Columnar Cost Ledger, showing how the total cost of any work undertaken is arrived at, insert *pro forma* entries, and state what method you adopt of allocating indirect charges, and your reasons for so doing. (*Chartered Accountants.*)

15. What are the principles of Process Cost Accounts? Illustrate your answer by means of *pro forma* accounts of a manufacturing business to which Process Cost Accounts could apply with advantage. (*Chartered Accountants.*)

16. From the following figures taken from the books of the Alpha Manufacturing Company show in convenient form the Costing results for the two years:—

1st Year: Materials, £50,000; Wages, £30,000; Indirect Expenses, £10,000; Sales, £99,000.

2nd Year: The cost of Materials and Wages had increased by 25%, the Indirect Expenses by 5%, and the Sales by £28,075.

(*Institute of Book-keepers.*

17. You have been asked by a manufacturer to devise a system of Cost Accounts. Select a manufacturing business and state: (*a*) The various items of expense which you would include under the heading "Oncost"; (*b*) the source from which you would obtain the necessary figures upon inaugurating the Costing system; (*c*) the basis upon which you would allocate the Oncost expenses. (*London Chamber Commerce.*)

18. The weekly wages total of a factory, making sewing-machines, is analysed under the following heads: (1) Productive Labour. (2) Engine-room. (3) Repairs—(*a*) Engine-room Plant. (*b*) Belts, Pulleys, Shafting; (*c*) Lighting; (*d*) Machinery; (*e*) Buildings. (4) Store-keepers and Factory Clerical. (5) Watchman and Guard. (6) Factory, Executive and Supervision. (7) Office—(*a*) Orders and Stores; (*b*) Costing; (*c*) General. (8) Administrative. Select any four of these and state how they should be dealt with in the Costs. (*Chartered Accountants.*)

19. A manufacturer, whose business is divided into five departments, each situated in a different part of the same building, and each turning out a distinct class of article, wishes to ascertain the approximate cost of each type of article over a year.

Detailed records of stores and departmental wages books are kept.

State on what basis you would apportion the following items appearing in the Profit and Loss Account, and what additional information (not appearing in the ordinary books of account) would be necessary to enable this to be done (*a*) Carriage inwards; (*b*) Rent; (*c*) Machinery Depreciation; (*d*) Office Salaries (*e*) Heating and Lighting. (*London Chamber Commerce.*)

20. After charging up wages, material, and certain other expenses to th particular works in connection with which such expenditure was incurred, th books of a manufacturing company show additional expenditure under th following heads:—

Salaries—Works Engineers and Managers, £5,500; Travellers, £2,500 Administrative, £8,000. Rates, £2,000. Rent, £4,000. Commission, fares and allowances to travellers, £2,500. Carriage outwards, £650. Directors' Fees £1,000. Stationery—Works, £125. Stationery and Printing—Office, £375 Postages and Telegrams, £160. Depreciation—Buildings, £500; Plant an Machinery, £950. Fire Insurance, £350. Advertising and Catalogues, £1,250 Carriage inwards, £120.

Place each of these items under one of the following charge headings: (*a* Works; (*b*) Selling and Distributing; (*c*) Administrative; (*d*) General.

Of the rates and rent one-eighth is in connection with the Office. (*Incorpo ated Accountants.*)

21. The Trading and Profit and Loss Accounts of the Baxter Trading Company, Ltd., who deal in gramophones sold at £20 each net, for the year ende December 31, 19..., are as follows:—

TRADING ACCOUNT.

		£			£
Jan. 1.	To Stock	2,000	Dec. 31.	By Sales	15,00
Dec. 31.	,, Materials	3,875		,, Stock	1,00
	,, Wages	6,000			
	,, Gross Profit	4,125			
		£16,000			£16,00

PROFIT AND LOSS ACCOUNT.

		£			£
Dec. 31.	To General Expenses	1,500	Dec. 31.	By Gross Profits	4,12
	,, Depreciation	750			
	,, Directors' Remuneration	375			
	,, Net Profit	1,500			
		£4,125			£4,12

CHAPTER XVI

HIRE-PURCHASE ACCOUNTS

A very large quantity of commodities change hands under what are known as "hire-purchase" contracts. These contracts, as well as "Credit Sales Agreements" (*i.e.* agreements for sale with payment by instalments) are subject to the Hire Purchase Act 1938.

Hire-Purchase.—The essence of the contract is that the goods which form its subject remain the property of the "owner," but the "hirer" has the use of them on paying the first of a number of agreed instalments. On payment of the final instalment the legal ownership passes to the "hirer" and the previous "owner" has no further interest. If the hirer fails to complete the agreed payments the owner may recover the goods or a fair proportion of them, and the Act contains detailed provisions for the protection of the hirer. If the hirer has paid not less than one third of the total hire-purchase price, the owner cannot enforce recovery of the goods except by obtaining an order from the court, and the court will determine what is a fair proportion, if any, for the hirer to retain. On the other hand, the hirer may if he wishes at any time give notice to terminate the agreement and return the goods, and is then liable to pay the amount (if any) by which one-half of the total hire-purchase price exceeds the total of the sums already paid. If the goods have been damaged before the hirer returns them in accordance with this provision he is liable to pay for such damage.

From the book-keeping point of view, it is important to realise that in such a transaction there is no *sale*. The only book debt created is a claim for the unpaid instalments, which lapses if the goods are returned, or reclaimed, owing to the hire-purchaser's default in paying the instalments. The proper treatment to be followed by the hire-seller is to ascertain the cost of the goods out on hire, and to deal with them as stock.

This treatment may be simply illustrated as follows:—

HIRE-PURCHASE TRADING ACCOUNT.

Three Articles on Hire. Cost, £120. Payable in three annual instalments of £20 each article.

DR.	£	s.	d.	CR.	£	s.	d.
Cost of Articles . .	120	0	0	Cash, First Years' Instalments . .	60	0	0
Balance, being Gross Profit . . .	20	0	0	Value of Stock, *i.e.* Cost, £120, *less* £40, to reduce value to cost price . .	80	0	0
	£140	0	0		£140	0	0

The hire-purchaser's position is that he is acquiring an asset at a total cost in excess of the cash-down price. Moreover, the asset is not his legal property until all the instalments have been paid. How is he to treat the instalments in his books? Assuming that it is his intention to complete the agreement, he is justified in charging the asset account, headed, *e.g.* by some such caption as "Motor Lorries in Course of Hire-Purchase," with the cash-down price, and treating the balance as cost of hire or as interest. However, since the assets are not the legal property of the hire-purchaser the Balance Sheet must be so worded as to indicate the fact, *e.g.* "Motor Vehicles in course of acquisition under Hire Purchase Contracts" showing the full cash price as "Cost." Depreciation must, of course, be provided, and will be treated exactly as though the assets in question had been paid for in the ordinary way. On the other hand, the (present value of) unpaid instalments would be included among the Current Liabilities.

Payment-by-instalment Method.—A contract of sale on the instalment-payment system is an *out-and-out sale* under agreement that the purchase price shall be discharged by a definite number of payments made at definite dates. Possession and legal ownership of the goods pass to the purchaser immediately he signs the agreement and pays the first instalment. The vendor has, then, no rights over the goods, but he can, of course, sue the purchaser for any instalment that he may fail to pay. Thus, from the vendor's point of view, the transaction is a conversion of stock into a book debt payable by instalments; from the purchaser's point of view it is the acquirement of an asset, the purchase price of which is a debt due from him. Here, again, whether the debt is paid or not, the asset will depreciate.

Analysis of the Purchase Price.—It is clear that the price to be paid for the goods under either of the above systems of purchase is greater than the cash-down price. The price may be said to comprise three elements: (*a*) the cash-down price, plus (*b*) interest on the unpaid portion of that price, plus (*c*) an addition, or loading to cover the risk of default. Although, in the case of hire-purchase, the vendor is in theory secured by being able to recover at least a fair porportion of the goods if the hirer defaults, yet there is always the risk of loss by damage or fraud. In any case, should default be made, the goods will be second-hand, even if they are not actually damaged, and so of less value than they were at the time of transfer. It follows, therefore, that the whole hire-purchase, or deferred-payment, price cannot be credited by the vendor to his Trading Account; and that from the purchaser's standpoint the periodical payments which he is under obligation to make comprise both capital and revenue items.

Treatment in Books of Account.

Seller's Books.—Broadly speaking, the seller regards the transaction as a cash sale. He adds to the cash price interest, at a rate considerably higher than what would be obtained by the investment of money in sound securities, in order to cover possible losses by default, and he divides this composite price by the agreed number of instalments. He then treats the sale as a sale for deferred payments by equal instalments. Provided that his loading for risk—the excess interest added to the cash price—is sufficient, there is little danger in this method. In order to reduce the volume of book-keeping entries in this sort of transaction certain methods have been adopted, and, accordingly, three typical sets of circumstances are dealt with below, and the system applicable to each is described.

The details of the various agreements met with in practice will, of course, vary considerably. For example, it is usual for the first instalment to be paid on signing the agreement. This practice reduces the unpaid balance of the cash-down price on which interest is calculated. Again, the instalments may be determined by dividing the cash-down price by the agreed number of instalments, and adding to each interest on the outstanding balance. If that is done, the instalments will not be equal, but will gradually decrease. Such inducements to purchase as "free insurance," "service after purchase," or an option to terminate the agreement at will and return a portion of the goods, etc., will need consideration in deciding the precise form of treatment to adopt in a particular case. Still the general principles will remain the same.

(i) *Where goods sold on hire-purchase are of considerable value, and the number of transactions is small,* e.g. *Railway Wagons or Motor Lorries.*

Here the transaction is dealt with as an ordinary sale, the balance of the hire-purchase price being treated as interest and credited proportionately to the periods mentioned in the agreement. Thus the whole of the gross profit on the sale is credited to the Trading Account for the period when the sale was effected. This method assumes that the transaction is an ordinary sale with payment by instalments at interest; and in so far as losses are probable through default, provisions against such losses must be made. The balance of the personal account of the purchaser will appear on the asset side of the Balance Sheet as "Goods out on Hire-purchase," any provision being deducted therefrom. (See Illustration 1.)

(ii) *Where goods sold on hire-purchase are of small value, the sales considerable, and the periods of the agreements vary,* e.g. *in the Furnishing trade.*

Only memorandum records are kept of the personal aspect of the transactions. The goods are treated as stock and valued at each balancing date at a proportion of the cost of the goods equivalent to the proportion of the total instalments remaining unpaid. In other words, each instalment is considered as being composed of similar fractions of: (*a*) cost, and (*b*) gross profit and interest. A Hire-purchase Sales Day Book is ruled with suitable columns for information as to: (1) number of instalments; (2) interval between each instalment, *e.g.* week, month, or quarter; (3) total of instalments (the hire-purchase price); and (4) cost price. The equivalent cash selling price is ignored. A memorandum Hire-purchasers' Ledger is opened, each account being headed with full details as recorded in the Day Book. The memorandum personal account is debited with the full hire-purchase price, and credited periodically from the Cash Book with the instalments paid. These detail entries are memoranda only. The double-entry is put through in periodical totals. The total of the cost-price column of the Hire-purchase Sales Day Book is debited to "Stock out on Hire-purchase Account," and credited to Hire-Purchase Sales Account, and thence to the Trading Account. The total cash received on account of instalments is periodically posted to the credit of "Stock out on Hire-purchase Account." At balancing dates, this stock is valued by going through the Hire-purchaser's Ledger and valuing each account according to the following formula:—

$$\frac{\textit{Number of instalments still due} \times \textit{Cost price}}{\textit{Total number of instalments payable}}$$

The total stock is then inserted on the credit side of the Stock out on Hire-purchase Account, and carried down as a debit balance to the next period. The difference on this account then shows the profit or loss to be transferred to the Trading Account of the business in the ordinary way. (See Illustration 2.)

(iii) *Where goods are sold on hire-purchase, the period being fixed and the transactions considerable*, e.g. *a billiard-table manufacturer selling tables on monthly instalments over three years.*

The cash-price method explained in (i) is adopted with this variation, that the interest instead of being apportioned on the facts of each agreement is treated in total, this being possible owing to the period of each agreement being fixed. Thus, assume that all goods are sold on three-year agreements, the instalments being payable quarterly. Then, if the loading for interest and risk, is 8%, the interest applicable to each of the three years is: 1st year, 52·63%; 2nd year, 33·83%; 3rd year, 13·54% of the total interest.* Most agreements

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* The proportions of the total interest (*i.e.* the difference between the hire-purchase price and the cash-sale price) applicable to each year will vary with the rate per cent., the interval between the payments, and the total period of the agreement. But as all agreements are standardised, whatever the amount of the instalment may be, the interest included in any one instalment will always bear the same ratio to the interest included in any other instalment. Thus, if a typical example is taken, say a quarterly payment of £10 for three years, the "present worth" = the cash sale price is £105 15*s*. The total hire purchase price is £120, and thus the total interest is £14 5*s*. It will be found that £7 10*s*. of this, or 52·63% of the total interest, is applicable to the first year, thus:—

Balance at beginning of quarter.	Interest thereon at 8% p.a.	Total.	Quarterly instalment.	Balance.
£ *s*. *d*.	£ *s*. *d*.	£ *s*. *d*.	£ *s*. *d*.	£ *s*. *d*.
105 15 0	2 2 3	107 17 3	10 0 0	97 17 3
97 17 3	1 19 2	99 16 5	10 0 0	89 16 5
89 16 5	1 15 11	91 12 4	10 0 0	81 12 4
81 12 4	1 12 8	83 5 0	10 0 0	73 5 0
	£7 10 0			

The second year's interest will be found to be £4 16*s*. 5*d*., or 33·83%, and will extend over four years, since they are not all entered into on the first day of the business year. The interest is then approximated by taking credit only for one-half of the first year's interest in that year, then, in the second year, the other half of the first year's interest plus half of the second year's interest, and so on. The interest would be apportioned in the above example, as follows:—

First year		26·3%
Second year	(26·3 + 16·9) =	43·2%
Third year	(16·9 + 6·8) =	23·7%
Fourth year		6·8%
		100·0%

The Hire-Purchase Day Book is ruled to provide details of the various agreements and, in addition, three money columns for: (*a*) Cash Price, (*b*) Interest, (*c*) Total. Column (*c*) is debited to the individual personal accounts in the Hire-purchasers' Ledger, and these accounts are credited with the cash instalments as paid. Periodically, the totals of the Hire-purchase Day Book are posted: (*a*) to the credit of Hire-purchase Sales Account (and thence to the Trading Account); (*b*) to the credit of a Hire-purchase Interest Suspense Account for the period; and (*c*) the total, to the debit of a Hire-purchasers' Ledger Total Account. The latter account is credited periodically from the Cash Book with the total instalments received, and is operated in the same manner as a Total Debtors' Account. Each year the due percentage of each of the interest suspense accounts is credited to Profit and Loss Account. There will, at any time, be several suspense accounts open; for example, if the agreements are for three years, there will be three suspense accounts open, and each Profit and Loss Account will receive benefit from four different suspense accounts. In the Balance Sheet, the total credit balances on the interest suspense accounts are deducted from the debit balance on the Hire-purchasers' Ledger Total Account, and the net figure shown as "Stock in Hands of Customers on Hire-purchase Agreements." (See Illustration 3.)

Illustration 1.—The Sunlight Motor Company during the year 1932 sells the following on hire-purchase:—

(*a*) To the A. B. Carriage Company, one Lorry, cash selling price £500, payable by five yearly instalments of £115 9*s*. 9*d*. (Interest taken at 5%). Date of agreement, January 1, 1932.

(*b*) To the H. F. Meat Company, two Lorries, cash selling price £905 8*s*., payable by twelve half-yearly instalments of £100 (Interest taken at 6% with half-yearly rests). Date of agreement, June 1, 1932.

Show the personal accounts of the purchasers in the books of the Sunlight Motor Company up to December 31, 1933, and the entry in the Balance Sheet at that date, no loss on either agreement being anticipated.

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the third year's interest £1 18*s*. 7*d*., or 13·54%. This calculation will, of course, have to be made only once, *i.e.* when the exact terms of the standard agreement are decided upon. A fresh calculation would be necessary only if the rate per cent., or the frequency, or the number of the instalments is varied.

Sunlight Motor Company.

BALANCE SHEET, DECEMBER 31, 1933.

(ASSETS SIDE.)

	£	s.	d.
Lorries in hands of customers on Hire-Purchase agreements	£1,093	2	3

GENERAL LEDGER.

The A. B. Carriage Company.

Date : January 1, 1932. Sale of 1 Lorry.
Amount : £577 8*s.* 9*d.*
Payable by : 5 Yearly *Instalments of* £115 9*s.* 9*d.*
Commencing : December 31, 1932.
Cash Value : £500.
Interest : At 5%.

DR. CR.

		£	s.	d.			£	s.	d.
1932. Jan. 1	To Hire-purchase Sales Account (Cash Selling Price) . .	500	0	0	1932. Dec. 31	By Cash, 1st instalment .	115	9	9
Dec. 31	,, Interest Account (5% for 1 year) . .	25	0	0	,, 31	,, Balance carried down .	409	10	3
		£525	0	0			£525	0	0
1933. Jan. 1	To Balance brought down	409	10	3	1933. Dec. 31	By Cash, 2nd instalment .	115	9	9
Dec. 31	,, Interest Account (5% for 1 year) . .	20	9	6	,, 31	,, Balance carried down .	314	10	0
		£429	19	9			£429	19	9
1934. Jan. 1	To Balance brought down	314	10	0					

HIRE-PURCHASE INTEREST ACCOUNT.

DR. CR.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Profit and Loss Account . . .	54	17	3	1932. Dec. 31	By A. B. Carriage Co. .	25	0	0 ✓
					,, 31	,, H. F. Meat Co. . .	29	17	3 ✓
		£54	17	3			£54	17	3
1933. Dec. 31	To Profit and Loss Account . . .	73	16	6	1933. June 30	By H. F. Meat Co. . .	27	15	2
					Dec. 31	,, H. F. Meat Co. . .	25	11	10
					,, 31	,, A. B. Carriage Co. .	20	9	6
		£73	16	6			£73	16	6

The H. F. Meat Company.

Date : June 1, 1932. Sales of 2 Lorries.
Amount : £1,200.
Payable by : 12 Half-yearly *Instalments of* £100.
Commencing : December 31, 1932.
Cash Value : £995 8*s.*
Interest : At 6% (half-yearly rests).

[*continued on next page*

Dr. Cr.

		£	s.	d.			£	s.	d.
1932.					1932.				
June 1	To Hire-purchase Sales (Cash Selling Price) .	995	8	0	Dec. 31	By Cash, 1st instalment .	100	0	0
Dec. 31	" Interest Account (6% for 6 months) .	29	17	3	" 31	" Balance carried down .	925	5	3
		£1,025	5	3			£1,025	5	3
1933.					1933.				
Jan. 1	To Balance brought down	925	5	3	June 30	By Cash, 2nd instalment .	100	0	0
June 30	" Interest Account (6% for 6 months) .	27	15	2	" 30	" Balance carried down .	853	0	5
		£953	0	5			£953	0	5
1933.					1933.				
July 1	To Balance brought down	853	0	5	Dec. 31	By Cash, 3rd instalment .	100	0	0
Dec. 31	" Interest Account (6% for 6 months) .	25	11	10	" 31	" Balance carried down .	778	12	3
		£878	12	3			£878	12	3
1934.									
Jan. 1	To Balance brought down	778	12	3					

Hire-Purchase Sales Account.

Dr. Cr.

		£	s.	d.			£	s.	d.
1932.					1932.				
Dec. 31	To Trading Account .	1,495	8	0	Jan. 1	By A. B. Carriage Co. . .	500	0	0
					June 1	" H. F. Meat Co. . .	995	8	0
		£1,495	8	0			£1,495	8	0

Illustration 2.—The following are the entries in the Hire-purchase Day Book of the Ford Furnishing Company, who inaugurated a system of "easy payments" on July 1, 1932. Show the personal account of A. Black in the Hire-purchasers' Memorandum Ledger, and the Stock out on Hire-purchase Account in the General Ledger on December 31, 1932, assuming all instalments were received as and when due.

HIRE-PURCHASE DAY BOOK.

Date.	Agreement No.	Details.	Total instalments. £	s.	d.	Folio.	Cost price. £	s.	d.
1932.									
July 1	1	A. Black, 10, Lime Avenue, S.E. Bedroom Suite, 12 monthly instalments of £2 commencing July 1.	24	0	0	1	14	0	0
Aug. 10	2	K. Wright, Deepdene, Purley. 4 quarterly instalments of £13 commencing August 10	52	0	0	3	30	0	0
Sept. 15	3	M. Tyron, 14, The Drive, Wanstead. 24 monthly instalments of £3 commencing September 15	72	0	0	5	48	0	0
Oct. 1	4	B. Fore, Rahere, Dorking. 6 monthly instalments of £10 commencing October 1	60	0	0	7	40	0	0
Nov. 30	5	W. Seed, 91, High Street, W. 8 quarterly instalments of £15 commencing November 30	120	0	0	9	72	0	0
Dec. 7	6	B. Smith, 14, Sunray Avenue, N. 52 weekly instalments of £1 10s. commencing December 7	78	0	0	11	50	0	0
			£406	0	0		£254	0	0

HIRE-PURCHASERS' MEMORANDUM LEDGER.

Name of Hire-Purchaser : A. Black.
Address : 10, Lime Avenue, S.E.
Agreement Number : 1.
Date : July 1, 1932.
Articles : Bedroom Suite.
Cost Price : £14.
Instalments : 12, monthly, £2 each July 1 and thereafter
Total Instalments : £24.

Dr. Cr.

		D. B.	£	s.	d.			C. B.	£	s.	d.
1932. July 1	To Total Instalments	1	24	0	0	1932. July 1	By Cash . . .	25	2	0	0
						Aug. 1	" Cash . . .	27	2	0	0
						Sept. 1	" Cash . . .	29	2	0	0
						Oct. 1	" Cash . . .	28	2	0	0
						Nov. 1	" Cash . . .	24	2	0	0
						Dec. 1	" Cash . . .	27	2	0	0
						" 31	" Balance carried down . . .	✓	12	0	0
			£24	0	0				£24	0	0
1933. Jan. 1	To Balance brought down . .	✓	12	0	0						

GENERAL LEDGER.

Stock out on Hire-purchase.

Dr. Cr.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Cost of Stock sent out under Hire-purchase Agreements during the year (as per Hire-purchase Sales Day Book) . .	254	0	0	1932. Dec. 31	By Cash (Instalments received from Hire-purchasers during the year)	101	0	0
" 31	" Profit and Loss Account (profit on hire-purchase business for the year) . .	38	3	1	" 31	" Value of Stock out on hire-purchase at end of year (see schedule) .	191	3	1
		£292	3	1			£292	3	1
1933. Jan. 1	To Value of stock out on hire-purchase at this date . . .	191	3	1					

Hire-purchase Sales.

Dr. Cr.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Trading Account .	254	0	0	1932. Dec. 31	By Stock out on Hire-Purchase Account . .	254	0	0

VALUATION OF HIRE-PURCHASE STOCK AT DECEMBER 31, 1932.

Hire-purchase ledger folio.	Total number of instalments.	Number paid.	Number unpaid.	Cost. £	s.	d.	Proportion of cost.	Value of stock. £	s.	d.
1	12	6	6	14	0	0	6/12	7	0	0
2	4	2	2	30	0	0	2/4	15	0	0
3	24	4	20	48	0	0	20/24	40	0	0
4	6	3	3	40	0	0	3/6	20	0	0
5	8	1	7	72	0	0	7/8	63	0	0
6	52	4	48	50	0	0	48/52	46	3	1
	106	20	86					£191	3	1

If goods are returned and the agreement is cancelled, the cost price unpaid must be credited to Stock out on Hire-purchase Account, and debited to Hire-purchase Returns Account, the goods being taken into general stock at a valuation, and any balance being written off. For example, if A. Black, makes no further payments and the goods are seized, Stock out on Hire-purchase Account will be credited with £7 and Hire-purchase Returns Account debited. If the goods returned are worth only £4, Trading Account will be debited with £4; Profit and Loss Account be debited with the loss of £3; and Hire-purchase Returns Account be credited with £7.

Illustration 3.—The Fibre Gramophone Company manufactures a number of instruments ranging in price from £3 to 100 guineas. These are sold for cash or on the hire-purchase system. The hire-purchase price is based on the cash selling price, to which interest is added at 8% per annum, with quarterly rests. The hire-purchase agreements provide that the total hire-purchase price shall be payable by twelve equal quarterly instalments, the first being due three months after the date of the agreement. The interest is treated in total in the company's books, being spread over four years (the year in which the agreement is signed and the three following years) in the proportions: 26·3%; 43·2%; 23·7%; and 6·8% respectively.

The following are details of the hire-purchase transactions for the year to December 31, 1932:—

		£	s.	d.
Total hire-purchase agreements effected during the year . . (This sum is made up of Cash selling price, £10,575 + Interest = £1,425.)	=	12,000	0	0
Cash instalments received during the year	=	7,200	0	0
Hire-purchasers' Ledger Total Account (Debit balance), January 1, 1932	=	10,700	0	0
Interest Suspense Account, 1929 (Credit balance), January 1, 1932	=	9	13	10
Interest Suspense Account, 1930 (Credit balance), January 1, 1932	=	217	6	3
Interest Suspense Account, 1931 (Credit balance), January 1, 1932	=	787	13	5

Show the appropriate accounts in the books of the Fibre Gramophone Company for the year ended December 31, 1932.

HIRE-PURCHASE INTEREST SUSPENSE ACCOUNT, 1929.

Total, £142 10s. Chargeable: 1929, 26·3%, £37 9s. 6d.; 1930, 43·2%, £61 11s. 2d.; 1931, 23·7%, £33 15s. 6d.; 1932, 6·8%, £9 13 10d.

Dr. Cr.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Profit and Loss Account	9	13	10	1932. Jan. 1	By Balance brought forward . . .	9	13	10

HIRE-PURCHASE INTEREST SUSPENSE ACCOUNT, 1930.

Total, £712 10*s.* Chargeable: 1930, 26·3%, £187 7*s.* 9*d.*; 1931, 43·2%, £307 16*s.*; 1932, 23·7%, £168 17*s.* 3*d.*; 1933, 6·8%, £48 9*s.*

Dr. Cr.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Profit and Loss Account	168	17	3	1932. Jan. 1	By Balance brought forward	217	6	3
,, 31	,, Balance carried down	48	9	0					
		£217	6	3			£217	6	3
					1933. Jan. 1	By Balance brought down	48	9	0

HIRE-PURCHASE INTEREST SUSPENSE ACCOUNT, 1931.

Total, £1,068 15*s.* Chargeable: 1931, 26·3%, £281 1*s.* 7*d.*; 1932, 43·2%, £461 14*s.*; 1933, 23·7%, £253 5*s.* 11*d.*; 1934, 6·8%, £72 13*s.* 6*d.*

Dr. Cr.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Profit and Loss Account	461	14	0	1932. Jan. 1	By Balance brought forward	787	13	5
,, 31	,, Balance carried down	325	19	5					
		£787	13	5			£787	13	5
					1933. Jan. 1	By Balance brought down	325	19	5

HIRE-PURCHASE INTEREST SUSPENSE ACCOUNT, 1932.

Total, £1,425. Chargeable: 1932, 26·3%, £374 15*s.* 6*d.*; 1933, 43·2%, £615 12*s.*; 1934, 23·7%, £337 14*s.* 6*d.*; 1935, 6·8%, £96 18*s.*

Dr. Cr.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Profit and Loss Account	374	15	6	1932. Dec. 31	By Hire-purchasers' Ledger Total Account	1,425	0	0
,, 31	,, Balance carried down	1,050	4	6					
		£1,425	0	0			£1,425	0	0
					1933. Jan. 1	By Balance brought down	1,050	4	6

HIRE-PURCHASE SALES ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Trading Account	10,575	0	0	1932. Dec. 31	By Hire-purchasers' Ledger Total Account	10,575	0	0

HIRE-PURCHASERS' LEDGER TOTAL ACCOUNT.

Dr. **Cr.**

		£	s.	d.			£	s.
1932. Jan. 1	To Balance brought forward . . .	10,700	0	0	1932. Dec. 31	By Cash instalments received . . .	7,200	0
Dec. 31	„ Hire-purchase Sales for year . . .	12,000	0	0	„ 31	„ Balance carried down .	15,500	0
		£22,700	0	0			£22,700	0
1933. Jan. 1	To Balance brought down.	15,500	0	0				

PROFIT AND LOSS ACCOUNT, 1932.

Dr. **Cr.**

£	s.	d.			£	s.
			1932. Dec. 31	By Hire-purchase Interest, 1929 . . .	9	13
			„ 31	„ Hire-purchase Interest, 1930 . . .	168	17
			„ 31	„ Hire-purchase Interest, 1931 . . .	461	14
			„ 31	„ Hire-purchase Interest, 1932 . . .	374	15
					£1,015	0

The Fibre Gramophone Company.

BALANCE SHEET, DECEMBER 31, 1932.

(Assets Side.)

	£	s.	d
Stock in hands of customers on Hire-purchase Agreements .	14,075	7	1

Note.—This figure is arrived at as follows :—

	£	s.	d.	£	s.	d.
Hire-purchasers' Ledger Total Account (Debit balance) . . .				15,500	0	0
Less Credit balances on Hire-purchase Interest Suspense Accounts :—						
1930	48	9	0			
1931	325	19	5			
1932	1,050	4	6			
				1,424	12	11
				£14,075	7	1

Illustration 4.—The A. B. Carriage Company purchased on January 1, 1932, from the Sunlight Motor Company one lorry on a hire-purchase agreement providing for the payment of five yearly instalments of £115 9*s*. 9*d*. each. The Sunlight Motor Company charges interest at 5%. Reference to an annuity table gives the present value of an annuity of £1 for five years at 5% as 4·329477. Depreciation is to be written off at 10% per annum. Show the accounts in the books of the Carriage Company.

(The cash value of the motor is 115·398 × 4·329477 = £500.)

The A. B. Carriage Company.

JOURNAL.

		Dr. £	s.	d.	Cr. £	s.	d.
1932. Dec. 31	Motor Lorry (Hire-Purchase Account) . . . . Dr.	90	9	9			
	Hire Account (5% on £500) . . . . . . Dr.	25	0	0			
	To Sunlight Motor Co.				115	9	9
	Being first instalment payable under Hire-Purchase agreement dated January 1, 1932, providing for 5 yearly instalments of £115 9s. 9d. commencing December 31, 1932. Cash price £500; interest taken at 5%.						
1933. Dec. 31	Motor Lorry . . . . Dr.	95	0	3			
	Hire Account (5% on £409 10s. 3d.) . . . . Dr.	20	9	6			
	To Sunlight Motor Co.				115	9	9
1934. Dec. 31	Motor Lorry . . . . Dr.	99	15	3			
	Hire Account (5% on £314 10s. 0d.) . . . . Dr.	15	14	6			
	To Sunlight Motor Co.				115	9	9
1935. Dec. 31	Motor Lorry . . . . Dr.	104	15	0			
	Hire Account (5% on £214 14s. 9d.) . . . . Dr.	10	14	9			
	To Sunlight Motor Co.				115	9	9
1936. Dec. 31	Motor Lorry . . . . Dr.	109	19	9			
	Hire Account (5% on £109 19s. 9d.) . . . . Dr.	5	10	0			
	To Sunlight Motor Co.				115	9	9

MOTOR LORRY. HIRE-PURCHASE ACCOUNT.

Dr. | Cr.

		£	s.	d.			£	s.	d.
1932. Dec. 31	To Motor Co.	90	9	9	1936. Dec. 31	By Balance carried down .	500	0	0
1933. Dec. 31	" Motor Co.	95	0	3					
1934. Dec. 31	" Motor Co.	99	15	3					
1935. Dec. 31	" Motor Co.	104	15	0					
1936. Dec. 31	" Motor Co.	109	19	9					
		£500	0	0			£500	0	0
1937. Jan. 1	To Balance brought down .	500	0	0					

MOTOR LORRY. ACCUMULATED DEPRECIATION.

Dr. | Cr.

		£	s.	d.			£	s.	d.
					1932. Dec. 31	By Profit and Loss Account (10% on £500) . .	50	0	0
					1933. Dec. 31	" Profit and Loss Account (10% on £450) . .	45	0	0
					1934. Dec. 31	" Profit and Loss Account (10% on £405) . .	40	10	0
					1935. Dec. 31	" Profit and Loss Account (10% on £364 10s. 0d.)	36	9	0
					1936. Dec. 31	" Profit and Loss Account (10% on £328 1s. 0d.).	32	16	1
							£204	15	1

SUNLIGHT MOTOR COMPANY (HIRE-PURCHASE ACCOUNT).

Dr. Cr.

		£	s.	d.			£	s.	d.
1931.					1932.				
Dec. 31	To Cash	115	9	9	Dec. 31	By Sundries . . .	115	9	9

(And so on for five years.)

Note.—The above treatment involves two assumptions, viz. (1) that depreciation is provided on the "diminishing balance system," and (2) that depreciation is being accumulated in a separate account. As mentioned in an earlier chapter this method is now advocated universally, because of the assistance it provides in compiling the figures required by the Companies Act, 1948. Where assets under hire-purchase contracts are in question it is doubly advisable, since if the depreciation were credited to the Asset Account year by year this account would become very confusing.

Illustration 5.—The H. F. Meat Company purchases two Motor Lorries from the Sunlight Motor Company on a hire-purchase agreement dated July 1, 1932, providing for twelve half-yearly instalments of £100, commencing December 31, 1932. The cash purchase price of the lorries is £995 8*s*., interest being computed at 6%, with half-yearly rests.

Show the accounts of the H. F. Meat Company up to December 31, 1933, and the entries in the Balance Sheet as at that date. Write off depreciation at 10% per annum.

The H. F. Meat Company.

JOURNAL.

			Dr.			Cr.		
			£	s.	d.	£	s.	d.
1932.								
July 1	Motor Lorries (Hire-purchase Account) . . .	Dr.	995	8	0			
	To Sunlight Motor Co.					995	8	0
	Being present worth of 12 half-yearly instalments of £100 commencing December 31, 1932, payable under agreement dated July 1, 1932. Interest at 6% with half-yearly rests.							

SUNLIGHT MOTOR COMPANY (HIRE-PURCHASE ACCOUNT).

Dr. Cr.

		£	s.	d.			£	s.	d.
1932.					1932.				
Dec. 31	To Cash	100	0	0	July 1	By Motor Lorries Account	995	8	0
,, 31	,, Balance carried down .	925	5	3	Dec. 31	,, Interest Account (6% for 6 months) . .	29	17	3
		£1,025	5	3			£1,025	5	3
1933.					1933.				
June 30	To Cash	100	0	0	Jan. 1	By Balance brought down	925	5	3
,, 30	,, Balance carried down .	853	0	5	June 30	,, Interest Account (6% for 6 months) . .	27	15	2
		£953	0	5			£953	0	5
1933.					1933.				
Dec. 31	To Cash	100	0	0	July 1	By Balance brought down.	853	0	5
,, 31	,, Balance carried down .	778	12	3	Dec. 31	,, Interest Account (6% for 6 months) . .	25	11	10
		£878	12	3			£878	12	3
					1934.				
					Jan. 1	By Balance brought down	778	12	3

MOTOR LORRIES (HIRE-PURCHASE ACCOUNT)

Dr.		£	s.	d.			£	s.	d. Cr.
1932.					1932.				
July 1	To Sunlight Motor Co. .	995	8	0	Dec. 31	By Depreciation 10% on (£995 8s. 0d. for 6 mos.)	49	15	5
					" 31	" Balance carried down .	945	12	7
		£995	8	0			£995	8	0
1933.					1933.				
Jan. 1	To Balance brought down .	945	12	7	Dec. 31	By Depreciation (10% on £945 12s. 7d.) .	94	11	3
					" 31	" Balance carried down .	851	1	4
		£945	12	7			£945	12	7
1934.									
Jan. 1	To Balance brought down .	851	1	4					

The H. F. Meat Company.

BALANCE SHEET, DECEMBER 31, 1933.

	£	s.	d.		£	s.	d.	£	s.	d.
(Under Current Liabilities.) Instalments on Hire-purchase contracts	778	12	3	Motor Lorries on Hire-purchase, at cash purchase price . . .	995	8	0			
				Less Aggregate Depreciation	144	6	8			
								851	1	4

Sales for Deferred Payments by Instalments.[*]

In the books of the buyer the entries are the exact converse of those in the books of the seller. The full cash price will be debited to the Asset Account, the instalments of interest being charged to revenue, and depreciation must be provided in the ordinary way.

Since an outright sale has taken place there can be no entries regarding hire in the books of either seller or buyer. The normal course, in the books of the seller, is to debit the buyer with the full cash price of the article when the sale is effected and subsequently with instalments of interest as they fall due. In the annual Accounts of the seller the asset has been completely eliminated from stock, and any balance due from the purchaser will appear under current liabilities. If transactions of this type are numerous it may be advisable to segregate the total of such debtors from ordinary trade debtors in the Balance Sheet on account of the abnormally long period of credit involved; otherwise a wrong impression regarding the working capital may be conveyed. Further, it is, of course, necessary to make ample provision against possible bad debts.

EXAMINATION QUESTIONS.

1. Differentiate between Hire-purchase and Instalment Payment.

2. The Three Speed Motor Company, Ltd., sold a car (No. 3786) to Hugh Dickson on hire-purchase terms as follows: total purchase price of car, £600, payable in ten quarterly (usual quarter-days) instalments of £60 each. The cost price of the car to the Company was £430.

State how the Company should record this transaction in their books, and illustrate your answer by *two only* of the Ledger Accounts you describe. (*Royal Society Arts.*)

3. What are the main features of hire-purchase agreements, and how would you show in the accounts the total amounts due under such agreements, and the various instalments payable from time to time thereunder? (*Incorporated Accountants.*)

4. Explain what you understand by a hire-purchase agreement. Show how the books of a furniture dealer, selling goods on the hire-purchase system, should be kept, and insert a few typical entries in the various books which you name.

Show on what principles the Trading Account and Balance Sheet of a business of this kind should be constructed. (*Incorporated Accountants.*)

5. A Sand and Gravel company hires 100 wagons on the deferred-purchase system over a term of seven years, the rent being payable by quarterly instalments of £200, with an addition for repairs of £2 per wagon per annum. Assuming the wagon company's charge for interest on the cash price of the wagons to be 5% per annum, make the Journal entries for the first year necessary to apportion the quarterly payments between Capital and Revenue.

6. A Sand and Gravel company purchased on December 31, 19..., railway wagons for £1,000, payable £100 down and the balance spread over three years by equal annual instalments plus 5% interest on the balance outstanding. Depreciation at 10% is written off by the company. Show the entries required in the books of the colliery company balancing the accounts annually.

7. On March 1 the B. S. Sand Company obtained wagons on the hire-purchase system. The price of the wagons was £1,150. Payment was to be made, as to £150 down and as to the balance at £200 per year with 5% interest.

The B. S. Coal Company write off 10% depreciation each year.

Construct the necessary Ledger Accounts in the books of the company, showing in detail the entries.

8. The Hard Coal Colliery Company, Ltd., agreed to purchase from the International Wagon Company, Ltd., 100 railway wagons, at the price of £50 per wagon, paying for the same by half-yearly instalments of £300, such instalments to include interest on the unpaid purchase money at the rate of 7% per annum.

The date of the purchase was January 1, and the first half-yearly instalment was due July 1.

Write up the Hard Coal Colliery Company's Account in the Wagon Company's books for three years, and also write up the Wagon Account in the Colliery Company's books for the same period. (*Chartered Accountants.*)

CHAPTER XVII

ROYALTY ACCOUNTS

Definition.—Royalty is a money payment, in the nature of rent, made for the right to use, produce, or reproduce certain classes of property, *e.g.* patents, copyrights, mineral rights, etc., the legal ownership of which is vested in another. Thus, the owner of a patent is the patentee; the owner of the copyright in a play, book, musical composition, or work of art is the author or the artist; the owner of ungotten minerals is the owner of the land on or beneath which the minerals lie. A patentee, copyright owner, land-owner, etc., may sell his proprietary rights outright; or exploit them himself; or concede the rights of exploitation to others. If he concedes the rights, the consideration usually takes the form of a *royalty*, *i.e.* of the payment of a definite sum of money for each article sold made according to the patent; or for each copy of the play, book, musical composition, or other work of art reproduced and sold; or for each ton, or other measure, of minerals won. From the owner's point of view, royalties are income, after making provision for any capital expenditure incurred that may die with the patent, copyright, or other royalty-producing property. From the concessionaire's point of view, money paid as royalty forms part of the manufacturing or producing expenses of the business, and should be charged to Manufacturing Account. Neither of these aspects offer any unusual book-keeping features, and need not be dealt with further.

Formerly, the most important instance of royalties in the United Kingdom was afforded by coal-mining royalties, and as a result of the special conditions obtaining in this and similar industries a somewhat special type of book-keeping was evolved in order to record these transactions. Since royalties on coal were acquired by the State and subsequently the whole of the coal-mining industry has been nationalised, the necessity for this type of record no longer arises in this particular connection. However, somewhat similar conditions may still arise in connection with collieries abroad and other types of "extractive" industry in this country, such as slate-quarries and gravel-pits, so that the matter which follows here is still of practical interest, and examination questions dealing with this subject will doubtless continue to be set.

Development Expenditure.—In the case of a new colliery, the cost of development, *i.e.* of sinking shafts, cutting main roads, installing pumping and ventilating machinery, and erecting surface buildings with their machinery, is capitalised. When the production stage has been reached, the method to be adopted for writing off the expenditure over a term of years must be carefully considered. This is sometimes done by creating a Sinking Fund based upon output. In many cases the question of providing out of revenue for capital sunk in development is ignored. In such event all dividends received must be regarded as including a modicum of capital.

Mining Royalties.—These are calculated in various ways. Usually, they are based upon an agreed rate per ton, *e.g.* 6*d.* per ton. But sometimes the royalty varies for different seams; a greater royalty being paid on coal won from a thick seam that may be easy to work, than from a thin seam that may be difficult to work. When paying royalty, the lessee should deduct income tax at the current rate.

Minimum (Dead, or Fixed) Rent.—In order to ensure that the mineral value shall be adequately exploited, the majority of mining leases guarantee the lessor a fixed minimum rent, irrespective of the tonnage of coal won. This minimum, dead, or fixed rent merges into a royalty when the tonnage won is sufficiently large to cover the minimum, but it must be paid to the lessor whatever the tonnage won.

Surface Compensation.—Mining leases frequently provide for payment of compensation to the owner of the land should damage be caused to the surface by subsidence, dumping of refuse, or other cause. If such claims are likely to materialise, provision must be made to meet them. Reserves made for the purpose are usually based upon output.

Wayleaves.—These are charges or rents paid for the right to transport coal under or over land belonging to neighbouring landowners. The charge or rent is generally fixed upon the basis of the tonnage of coal transported.

Short-Workings (Shorts).—In the case of new collieries, the royalties during the first few years of mine development rarely reach the amount fixed as the minimum rent. The amount by which the royalty falls short of this rent is termed *short-workings*. Most mining leases include an "average clause," which give the lessee the right for a limited period (three to seven years) to recover these short-workings out of royalties as soon as the royalties payable exceed in amount the minimum rent. Briefly put, the lessor receives either the minimum rent or the agreed royalties, whichever is the greater. The royalty account is charged with royalty on the coal actually won, and the amount of the short-workings is carried forward as expenditure paid in advance throughout the period during which such short-workings are recoverable. Justification for this treatment depends upon the terms of the lease, and the probability of winning a tonnage output the royalties on which will, within the time allowed for recoupment, exceed the minimum rent. However, the carrying forward of the debit balance on Short-workings Account implies confidence on the part of the management that the short-workings will in fact be fully recouped in due course. Any balance which may be standing on the account at the end of the period of recoupment must, of course, be written off forthwith, since otherwise the following Balance Sheet will show as an asset something that is of no value. Similarly, if, at an earlier stage, there is serious doubt as to whether the short-workings will ever be fully recouped, prudence dictates that the balance should then be suitably written down, if not written off completely.

The entries during the periods in which the right to recoup short-workings exists may be summarised as follows:—

(a) *When the Royalty is less than the agreed minimum rent.*

Debit Royalty Account with the actual royalty earned;
Debit Short-workings Account with the deficiency;
Credit Lessor with the amount of the minimum rent.

The Royalty Account is closed by transfer to the Profit and Loss Account; the Lessor's Account is closed by payment of cash. The debit balance on Short-workings Account may be carried forward as a temporary asset if: (1) the right to recoup these short-workings exists in the following year or years, and (2) if it is probable that the output in future will be large enough to enable the short-workings to be recouped.

(b) *When the Royalty exceeds the minimum rent.*

(1) If there is a debit balance on Short-workings Account
Debit Royalty Account with the actual royalty earned;
Credit the landlord with the minimum rent;
Credit Short-workings Account with the excess.

(2) Where there are no short-workings to be recovered,
Debit Royalty Account with the actual royalty payable, and
Credit the landlord with the same amount.

It will be seen that, in any case, the Royalty Account is debited with the actual royalty payable on the coal "gotten," and closed by transfer to the Profit and Loss Account. Any amount brought forward from previous years on Short-workings Account, which is found to be irrecoverable, must be written-off to Profit and Loss Account as short-workings, and any amount by which the minimum rent exceeds the royalty in any year must, if no right exists to recoup it, be debited to that year's Profit and Loss Account as short-workings.

The following illustration should make the treatment clear.

Illustration.—The lease of a colliery is granted upon the basis of a royalty of 6*d*. per ton on the coal won, subject to a minimum rent of £1,000 per annum; the tenant has the right to recoup short-workings during the first seven years of the lease, but not afterwards. The output in tons was as follows: 1932, first year, 20,000; 1933, second year, 30,000; 1934, third year, 40,000; 1935, fourth year, 48,000; 1936, fifth year, 35,000; 1937, sixth year, 44,000; 1938, seventh year, 36,400; 1939, eighth year, 60,000. Ignore income tax.

Colliery Company.

JOURNAL.

		£	s.	d.	£	s.	d.
1932. Dec. 31	Royalty Account . . . . Dr.	500	0	0			
	Short-workings Account . . . . . . Dr.	500	0	0			
	To Landlord				1,000	0	0
	Being royalty of 6*d.* per ton on 20,000 tons raised and agreed minimum rent of £1,000.						
1933. Dec. 31	Royalty Account . . . . Dr.	750	0	0			
	Short-workings Account . . . . . . Dr.	250	0	0			
	To Landlord				1,000	0	0
	Being royalty of 6*d.* per ton on 30,000 tons raised and agreed minimum rent of £1,000.						
1934. Dec. 31	Royalty Account . . . . Dr.	1,000	0	0			
	To Landlord				1,000	0	0
	Being royalty of 6*d.* per ton on 40,000 tons raised.						
1935. Dec. 31	Royalty Account . . . . Dr.	1,200	0	0			
	To Landlord				1,000	0	0
	„ Short-workings Account				200	0	0
	Being royalty of 6*d.* per ton on 48,000 tons raised. Minimum rent of £1,000, and short-workings recovered £200.						
1936. Dec. 31	Royalty Account . . . . Dr.	875	0	0			
	Short-workings Account . . . . . . Dr.	125	0	0			
	To Landlord				1,000	0	0
	Being royalty of 6*d.* per ton on 35,000 tons raised and agreed minimum rent of £1,000.						
1937. Dec. 31	Royalty Account . . . . Dr.	1,100	0	0			
	To Landlord				1,000	0	0
	„ Short-workings Account				100	0	0
	Being royalty of 6*d.* per ton on 44,000 tons raised. Minimum rent of £1,000, and short-workings recovered £100.						
1938. Dec. 31	Royalty Account . . . . Dr.	910	0	0			
	Short-workings Account . . . . . . Dr.	90	0	0			
	To Landlord				1,000	0	0
	Being royalty of 6*d.* per ton on 36,400 tons raised and agreed minimum rent of £1,000.						
„ 31	Profit and Loss Account . . . . . . Dr.	665	0	0			
	To Short-workings Account				665	0	0
	Being short-workings written off as irrecoverable.						
1939. Dec. 31	Royalty Account . . . . Dr.	1,500	0	0			
	To Landlord				1,500	0	0
	Being royalty of 6*d.* per ton on 60,000 tons raised.						

The Royalty Account is closed each year by transfer to the Profit and Loss Account. The Landlord's Account is closed by the payment of cash. The balance on Short-workings Account is carried forward each year till 1938, when, the right of recoupment having ceased, the balance must be written off.

EXAMINATION QUESTIONS.

1. Explain the term "Royalties" as employed in connection with coal-mining, and describe the various bases upon which royalties are commonly calculated. (*Royal Society Arts.*)

SHORT-WORKINGS ACCOUNT.

Dr. Cr.

		£	s.	d.			£	s.	d.
19... Dec. 31	To Landlord . . .	500	0	0	19... Dec. 31	By Balance carried down	750	0	0
19... Dec. 31	,, Landlord . . .	250	0	0					
		£750	0	0			£750	0	0
19... Jan. 1	To Balance brought down	750	0	0	19... Dec. 31	By Landlord . .	200	0	0
						,, Balance carried forward . . .	550	0	0
		£750	0	0			£750	0	0
19... Jan. 1	To Balance brought down	550	0	0	19... Dec. 31	By Landlord . .	100	0	0
Dec. 31	,, Landlord . . .	125	0	0		,, Balance carried down	575	0	0
		£675	0	0			£675	0	0
19... Dec. 31	To Balance brought down	575	0	0	19... Dec. 31	By Profit and Loss Account . . .	665	0	0
	,, Landlord . . .	90	0	0					
		£665	0	0			£665	0	0

2. Explain briefly, by means of *pro-forma* examples, how "royalties" and "short-workings," arising out of a mining lease, are dealt with in the books of the lessee of a colliery. (*Royal Society Arts.*)

3. The Coaley Colliery Company, Ltd., pay a royalty to a ground landlord of 9*d.* per ton of coal raised, with a minimum of £1,200 per annum, with power to recoup short-workings. In the first year they raised 20,000 tons; in the second year, 30,000 tons; in the third year, 44,000 tons. How would you deal with these items year by year in the Profit and Loss Accounts and Balance Sheets of the Company? (*Lancashire and Cheshire Institutes.*)

4. The Coal Mine Company, Ltd., took a lease of a colliery from G. Risch for 99 years from September 29, at a ground rent of £50 a year, payable half-yearly, and a royalty of 6*d.* per ton, with a minimum royalty of £80 a year, payable half-yearly. During the first year the Company raised 2,500 tons, and during the second year ended September 29, 4,000 tons. The several amounts to G. Risch were paid twenty-one days after becoming due. Write up both Personal and Nominal Accounts, and balance them at the end of each year. (*Chartered Accountants.*)

5. A and B, colliery proprietors, take a 21 years' lease at a dead rent of £600 per annum, merging into a royalty of 1*s.* a ton. The dead rents are recoverable out of royalties paid within five years. 800 tons were raised the first year, 4,600 the second year, and 75,000 the third year. 100 colliery wagons were purchased on the hire-purchase system, by which the wagons, at the end of ten years, became their absolute property in consideration of 15*s.* a month for each wagon. It was assumed by the firm that each wagon would be worth £40 at the end of the ten years. Show the Ledger Accounts for Dead Rents, Royalties, Purchase of Wagons for the first three years. (*Chartered Accountants.*)

6. The United Coal Company, Ltd., are granted a lease of 21 years at a minimum rent of £4,000 per annum merging into a royalty rent of 6*d.* per ton of coal raised. During the first year the output was 90,000 tons; during the second year the output was 160,000 tons; and during the third year the output was 250,000 tons. Make the necessary Journal Entries and write up the Personal and Nominal Ledger Accounts affected. (*Incorporated Accountants.*)

CHAPTER XVIII

INSOLVENCY

[*Note.*—The abbreviation R.O. used in this chapter = Receiving Order; O.R. = Official Receiver; C. of I. = Committee of Inspection; D. of A. = Deed of Arrangement; B.R. = *Bankruptcy Rules*, 1915–1926. The references are to the *Bankruptcy Act*, 1914, unless otherwise stated.]

It is necessary at the outset to distinguish between Insolvency and Bankruptcy. *Insolvency* is the state of a debtor who is unable to pay his debts as they fall due; *Bankruptcy* occurs when the affairs of the insolvent debtor have been brought to the knowledge of the Court, and he has been adjudged bankrupt by the Court, under the bankruptcy laws. Many insolvent persons never reach the stage of bankruptcy. They compound with their creditors under *Deeds of Arrangement*, as explained below, and so escape the stigma of bankruptcy proceedings. Nevertheless, such persons are frequently, but incorrectly, referred to as bankrupts.

There are degrees of insolvency. An insolvent person, hampered only by a small deficiency of assets, might continue to trade and incur fresh debts; and, if success should attend him, might succeed in regaining his solvency. But, generally speaking, it is not in the interests of the trading community that insolvent persons should continue to add to their liabilities in the, usually, vain hope of recovering their position. Commonly, the insolvent person needs to be protected from himself; his assets must be safeguarded so that his creditors shall receive their *pro rata* share of them; and, when he has satisfied his creditors to his utmost capacity, it is but fair that he should be freed from further liability in respect of his past trading, in order that he may be able to make a fresh start. These are the humane and just objects that the *Bankruptcy Act*, 1914, *The Bankruptcy (Amendment) Act*, 1926, and the *Bankruptcy Rules*, 1915–1926, which now govern all proceedings in bankruptcy, are designed to secure.

Who may be made Bankrupt.—Any adult person who has committed an Act of Bankruptcy within three months of the date of the petition, and whose debt or debts to the petitioning creditor or creditors amount to £50 may be made a bankrupt. It is doubtful if an infant can be made bankrupt, but perhaps he can after he has attained his majority, if the debts were contracted for "necessaries."

Foreigners.—An alien debtor may be made bankrupt if he is subject o English bankruptcy jurisdiction, and has committed an act of bankuptcy here.

Married Women.—Every married woman who carries on a trade r business, whether separately from her husband or not, is subject o the bankruptcy laws as if she were a single woman.

Lunatics.—Persons of unsound mind can apparently be made bankrupt only with consent of the Court in Lunacy, or on an act of bankruptcy committed while sane.

Convicts.—These may be made bankrupt.

Bankruptcy Petition.—Proceedings are begun by the presentation to the Court of a petition * asking for a *Receiving Order.* This may be done either by the debtor or by a creditor or creditors. If the debtor himself petitions, he must allege inability to pay his debts, and the Court will then immediately make the Order. Usually the petition is presented by one or more creditors, whose debt, or combined debts, amount to the sum of £50, and then the petition must show that the debtor has committed an act of bankruptcy within three months of the presentation of the petition. A sealed copy of the petition must be served on the debtor not less than eight days before the day fixed for hearing the petition. The granting of a R.O. does not make the debtor a bankrupt, but it protects his property by placing it under the control of an officer of the Court, termed the *Official Receiver.*

Acts of Bankruptcy.—An act of bankruptcy is an act, or default, of a debtor, deemed by the Court to be evidence of insolvency, any one of which, committed by a debtor, entitles a creditor to present a petition in bankruptcy against the debtor. Briefly stated, they are, by S. 1 (1), as follows :—

(1) If the debtor makes a conveyance or assignment of his property to a trustee or trustees for the benefit of his creditors generally.

(2) If he makes a fraudulent conveyance, gift, delivery, or transfer of his property or of any part thereof.

(3) If, being under no pressure so to do, he, with the intention of giving a creditor, or any surety or guarantor for the debt due to such creditor, a preference over the other creditors, makes any conveyance or transfer of his property or any part thereof, which in law would be void as a fraudulent preference if he were adjudged bankrupt.

(4) If, with intent to defeat or delay his creditors, he does any of the following things:—

(*a*) Departs out of England, or,
(*b*) Being out of England, remains out of England, or
(*c*) Departs from his dwelling-house, or otherwise absents himself; or begins to keep house.

(5) If execution against him has been levied by seizure of his goods under process in an action in any Court, or in any civil proceeding in the High Court, and the goods have been either sold or held by the sheriff for twenty-one days.

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* Upon the presentation of a Petition with the Official Receiver, the debtor must deposit £5. If a creditor petitions, he must deposit £7 10*s*., and such further sum as the Court may direct to cover fees and expenses. (*Bankruptcy Rules,* 1926.)

(6) If he files a declaration of his inability to pay his debts, or presents a bankruptcy petition against himself.

(7) If a creditor entitled to enforce a final judgment for any amount against the debtor serves on him a Bankruptcy Notice, and the debtor does not within seven days comply with the requirements of the notice.

(8) If the debtor gives notice to any of his creditors that he has suspended, or that he is about to suspend, payment of his debts.

Receiving Order.—If the petition is presented by a creditor, it must be verified by affidavit. At the hearing, the Court requires proof of the petitioning creditor's debt, evidence of the service of the petition, and proof of the commission of the act of bankruptcy. If the Court is satisfied on these points, it may make a R.O.

When the R.O. is made, the O.R. becomes the receiver of the debtor's property, and all actions against the debtor's person or property in respect of any debt provable in the bankruptcy are prohibited, except by leave of the Court, and on such terms as the Court may impose. The R.O. must be advertised in the *Gazette*, and in one local paper. The debtor is not yet a bankrupt. Before the Court will make an Adjudication Order declaring the debtor bankrupt, the debtor has to submit to the O.R., in duplicate, a Statement of Affairs as at the date of the R.O., attend the First Meeting of his creditors, and submit to his Public Examination.

Statement of Affairs.—After the R.O. is made, the debtor must make out and submit to the O.R. a Statement of Affairs, in the prescribed form. If the R.O. was made on the debtor's own petition, the statement must be submitted within three days of the date of the R.O., if on a creditor's petition, then within seven days of its date. If necessary, the debtor may obtain professional assistance in preparing this statement. Non-disclosure of any property by the debtor is a misdemeanour.

The official Statement of Affairs in bankruptcy consists of the following forms:—

(1) The "Front Sheet," which is a statement in summary form showing the debtor's estimate of his property and liabilities. The property is not shown at book values, or the values to the business as a going concern as in a Balance Sheet, but at the estimated realisable, or break-up values. The object of this statement is to estimate the amount available to meet the claims of unsecured creditors after paying off the preferential and secured creditors. Fully secured creditors holding property of the debtor may ignore the bankruptcy and rely on their security to satisfy their claims. Creditors but partly secured rank as unsecured creditors for the balance of their claims. The balance of this Statement will show either a deficiency or a surplus.

(2) Forms giving details of the totals shown in the summary Statement of Affairs: List A, Unsecured Creditors; B, Creditors Fully Secured; C, Creditors Partly Secured; D, Liability of Debtor on

Bills Discounted other than his own acceptances for value; E, Contingent or other liabilities; F, Creditors for Rent, etc., recoverable by distress; G, Preferential Creditors for Rates, Taxes, and Wages; H, Property; I, Debts due to the Estate; J, Bills of Exchange, Promissory Notes, etc., available as assets; L, In substitution for such of Sheets A to J as will have to be returned blank.

(3) The Deficiency (or Surplus) Account (List K). This explains how the deficiency (or surplus) shown in the Statement of Affairs arose. It is practically a Capital Account of the Debtor, and starts with the opening Capital (or Deficiency) at a date twelve months before the date of the R.O., or from such other date as the O.R. may fix. The net profit from the business and any other income during the period is also shown. Against this is set-off business losses (including the amounts written off assets brought into the Statement of Affairs below cost or book value), and expenses, other than trade expenses, such as household expenses. The balance of the account shows the deficiency (or surplus) as per the Statement of Affairs.

Preferential Creditors.—Certain unsecured debts are payable in priority to other unsecured debts; and as amongst themselves certain of these preferential debts have a pre-preference.

Preferential Debts with Pre-Preference.

(*a*) Money or property belonging to a Trustee Savings Bank which has come into the possession of a bankrupt official of the bank by virtue of his office (*Savings Bank Act*, 1863, S. 14).

(*b*) Money or property belonging to a Friendly Society held by a bankrupt official of the Society (*Friendly Societies Act*, 1895, S. 35).

(*c*) Where the estate of a deceased insolvent is being administered according to the laws of bankruptcy, the funeral and testamentary expenses incurred on behalf of the deceased by his legal personal representative (S. 130 (6)).

(*d*) The expenses of a Trustee under a D. of A. that has been avoided by bankruptcy, so far as they were incurred in carrying out the duties imposed by the *D. of A. Act*, 1914.

Preferential Debts.—By SS. 33 and 34, the following debts are paid after the costs of the bankruptcy have been defrayed and before other unsecured debts.

(*e*) All parochial or other local rates due from the bankrupt at the date of the R.O., and having become due and payable within twelve months next before that time, and all assessed taxes, land tax, or income tax,* assessed on the bankrupt up to the 5th day of April next before the date of the R.O., and not exceeding in the whole one year's assessment. The amount of any purchase tax due from the Bankrupt at the date of the R.O. and having become due within twelve months next before that date. If more than one year's taxes are due, the Revenue Authorities may select any one year as preferential, and rank as unsecured for the balance. Income Tax deducted from interest, etc., not payable or not wholly payable out fo profits or gains brought into charge (*Rule* 21, *General Rule*, *Income Tax Act*, 1918), and not handed over to the Revenue at the date of the R.O., can now be assessed under S. 26 *Finance Act*, 1927, and so made preferential.

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* Income Tax includes taxes assessed under any schedule, as well as profits tax and excess profits levy. Further (Finance Act, 1952), it now includes tax deducted from employees' remuneration under the P.A.Y.E. regulations.

(*f*) All wages or salary of any clerk or servant in respect of services rendered to the bankrupt during four months before the date of the R.O., not exceeding £200, whether or not earned wholly or in part by way of commission.

(*g*) All wages (whether payable for time or for piece work) of any workman or labourer, not exceeding £200, in respect of services rendered to the bankrupt during four months before the date of the R.O. Provided that, where any agricultural labourer has entered into a contract for the payment of a portion of his wages in a lump sum at the end of the year of hiring the priority shall extend to the whole of such sum, or part thereof, as the Court may decide to be due under the contract, proportionate to the time of service up to the date of the R.O.

(*h*) All accrued holiday remuneration becoming payable to any clerk, servant, workman, or labourer (or in the case of his death to any other person in his right) on the termination of his employment before or by effect of the receiving order.

(*i*) All amounts due in respect of compensation under the *Workmen's Compensation Acts*, the liability wherefor accrued before the date of the R.O., if the bankrupt is not insured, being amounts in satisfaction of a right which arises or has arisen in respect of employment before the 5th day of July 1948 (the day on which the *National Insurance Act*, 1946, became effective). (This is now of little more than historical interest.)

(*j*) All amounts due in respect of contributions payable during the twelve months next before the date of the R.O. under *National Insurance Act*.

Rent.—The landlord is not a preferential creditor, but his claim is usually settled with the preferential debts owing to his power of distress. He can distrain upon the goods or effects of the bankrupt, for the rent due to him from the bankrupt, at any time before or after the commencement of the bankruptcy; but if he distrains after the commencement he can only recover six months' rent acrrued due prior to the adjudication order. He ranks as an unsecured creditor for the balance.

Public Examination.—As soon as possible after the debtor has submitted his Statement of Affairs he is publicly examined in open Court, as to his conduct, dealings, and property. Any creditor who has tendered proof of his debt may question the debtor concerning his affairs and the causes of his failure.

First Meeting of Creditors.—The O.R. must, having given six clear days' notice in the *Gazette* and in a local paper, call a first meeting of creditors to be held not less than fourteen days after the date of the R.O., unless the Court appoints a later day. The O.R. sends to each creditor, mentioned in the Statement of Affairs, notice of the time and place of the meeting, and a copy of the summary statement of affairs—the "front sheet," together with his observations thereon. Forms for proof of debts, and proxies, and a copy of the scheme of composition or arrangement, if any is proposed by the debtor, are also sent to the Creditors.

The debtor must attend the meeting and answer questions put to him. The O.R. or his nominee acts as chairman. The main business of the meeting, after obtaining any information and explanations required from the debtor, is to decide whether the scheme of composition (if any) proposed by the debtor shall be accepted. In order to be binding, such a scheme must receive the assent of a majority in number representing three-fourths in value of *all* the creditors *who have proved* their debts, and must afterwards be sanctioned by the Court. Creditors may assent to, or dissent from, the scheme by means of a *Voting Letter*, which must reach the O.R. the day before the meeting. If no scheme is proposed, or if the scheme proposed is rejected, the creditors then decide whether the debtor shall be adjudicated bankrupt. If they so decide, they may then appoint a *Trustee* and a *Committee of Inspection*. This business is transacted by *Ordinary Resolution*, *i.e.* a resolution passed by a simple majority in value of the creditors present personally or by proxy at a meeting of creditors, and voting on the resolution. A *Special Resolution* is one decided by a majority in number and representing three-fourths in value of the creditors present personally or by proxy at a meeting of creditors, and voting on the resolution. Special resolutions are necessary: (*a*) to remove a *Special Manager*; (*b*) to make an allowance in kind to the bankrupt; (*c*) to resolve that some person other than the O.R. shall, in the case of a small bankruptcy, be appointed Trustee.

Small Bankruptcies.—These are bankruptcies where the assets are not likely to exceed £300. The O.R. acts as Trustee, except as above mentioned. In these bankruptcies, there is no C. of I., advertisements are dispensed with, and the estate is wound up in a summary manner.

Adjudication Order.—Where the creditors pass a resolution that the debtor shall be made bankrupt; or pass no resolution; or do not meet; or where a scheme is proposed, but is not approved within fourteen days of the conclusion of the public examination, or within such further time as the Court may allow; the Court will adjudge the debtor bankrupt. Thereupon the bankrupt's property vests in the Trustee and becomes divisible among the creditors. Adjudication Orders are advertised in the *Gazette* and in a local paper. Until a Trustee is appointed the property vests in the O.R. The adjudication order may be annulled if a Scheme of Arrangement or Composition is subsequently approved; or if the Court should afterwards decide that the debtor should not have been made bankrupt, and no offences against the bankruptcy laws are proved against him; or if the debts are paid in full. The commencement of the bankruptcy dates back to the date of the act of bankruptcy upon which the petition was founded, or to any previous act of bankruptcy which the trustee can prove to have been committed by the debtor within three months of the date on which the petition was presented. This doctrine of the "relation back" of the bankruptcy to the first available act of bankruptcy is often of the greatest assistance to the Trustee in enabling him to trace and attach the bankrupt's property.

Taking Possession of the Property.—As soon as the Trustee obtains his certificate of appointment, he proceeds to take possession of the bankrupt's property. The only property exempted is:—

(*a*) Property held by the bankrupt on trust for any other person;

(*b*) Trade tools, wearing apparel, and bedding to a value not exceeding £20 in all (S. 38).

Further:

(*c*) Property of the debtor the ownership of which, in the event of the debtor's bankruptcy, passes to others. But no one can settle his own property upon himself, so as to pass the property to others in the event of his bankruptcy.

(*d*) The benefit of contracts that can be carried out only by the personal skill of the bankrupt, *e.g.* contracts entered into by an actor, but to no greater extent than is reasonably sufficient to maintain the bankrupt and his family. These personal earnings may include commission earned by the bankrupt, but not the profits of a business, no matter how great the personal skill required for its conduct, *e.g.* dentistry.

(*e*) Where the bankrupt is a beneficed clergyman, an officer in the Army or Navy, or a Civil Servant, so much of the stipend as the bishop of the diocese, or the Court, with the consent of the chief officer of the department under which the stipend is enjoyed, as the case may be, shall reserve to the bankrupt (SS. 50 and 51 (1)).

(*f*) Where the bankrupt is in receipt of a salary or income other than mentioned in (*e*) above, or is entitled to any half-pay, or pension, or to any compensation granted by the Treasury, so much of this income as the Court may permit him to retain (S. 51 (2)).

Upon proof of his appointment, the Trustee becomes possessed of any stocks or shares held by the bankrupt, and can sell and transfer them. If the shares are not fully paid, the Trustee can disclaim them, and should do so if it is to the benefit of the estate, in which case the company can prove for any outstanding or future calls.

Property Divisible.—The property of the bankrupt divisible amongst e creditors is described by Section 38 as comprising:—

(*a*) All such property as may belong to or be vested in the bankrupt at the commencement of the bankruptcy, and all property that may be acquired by or devolve on him before his discharge; and the capacity to take proceedings for exercising all such powers in or over or in respect of property as might have been exercised by the bankrupt for his own benefit at the commencement of his bankruptcy or before his discharge, except the right of nomination to a vacant ecclesiastical benefice.

Property acquired by or devolving upon a bankrupt after the commencement of his bankruptcy is known as "After Acquired Property."

(*b*) All goods being, at the commencement of the bankruptcy, in the possession, order, or disposition of the bankrupt, in his trade or business, by the consent and permission of the true owner, under such circumstances that he is the reputed owner thereof, provided that things in action other than debts due or growing due to the bankrupt in the course of his trade or business shall not be deemed goods within the meaning of this section.

Committee of Inspection.—The creditors may, at their first or subsequent meeting, by resolution, appoint a C. of I. to superintend the administration of the estate by the Trustee. The Committee must consist of not less than three or more than five creditors who have proved their debts, or persons holding a general proxy or general power of attorney from such creditors. The C. of I. meets at such times as it may appoint, and, failing appointment, at least once a month. The Committee acts by a majority of its members. The Trustee must have regard to the Committee's instructions, and certain acts can be done only with the Committee's sanction. A member of the C. of I. may be removed by an ordinary resolution of the creditors. Where there is no Committee, the O.R. carries out its duties, subject to the direction of the Board of Trade. Members of the C. of I. are entitled to their expenses, but not to remuneration for their services, except by sanction of the Court. No member may, without leave of the Court, purchase any part of the debtor's estate, or, where the trustee is carrying on the debtor's business, derive any profit from supplying goods to the Trustee.

Proof of Debts.—As soon as possible after the R.O., creditors must prove their debts by lodging with the O.R., or the Trustee, an affidavit made personally or by their authorised agent. Proofs for claims exceeding £2, other than for workers' wages, or Crown debts, must bear a 1*s*. 6*d*. Bankruptcy Stamp, or a postal order for that sum must be sent to the O.R. or the Trustee. A single proof may be made by the debtor, or foreman, or other person on behalf of the workmen, for the total claim in respect of wages owing. Proofs of debt must be admitted or rejected by the Trustee within twenty-eight days of receipt, but where the O.R., or the Trustee, has given notice of his intention to declare a dividend, then within fourteen days of the date mentioned in the notice as the latest date by which proofs must be lodged.

Debts Provable in Bankruptcy.—All debts and liabilities, present or future, certain or contingent, to which the debtor is subject at the date of the R.O., or to which he may become subject before his discharge by reason of any obligation incurred before the date of the R.O., shall be deemed to be debts provable in bankruptcy (S. 30 [3]).

Debts not Provable.—The following are not provable in bankruptcy:—

(*a*) Demands in the nature of unliquidated damages arising otherwise than by reason of a contract, promise, or breach of trust.

(*b*) Debts or liabilities contracted by the debtor with any person who had notice prior to the contraction of the debt that the debtor had committed an available act of bankruptcy.

(*c*) Debts or liabilities, the value of which are, in the opinion of the Court, incapable of being fairly estimated (S. 30 [1], [2], and [6]).

Deferred Debts.—Certain debts, detailed on p. 694, are preferential; other debts are deferred, *i.e.* they do not rank for payment until the ordinary unsecured creditors have been paid in full. The following are deferred debts:—

(*a*) Money lent under a written contract, signed by, or on behalf of, all the parties thereto, to a person engaged, or about to engage, in business, whereby the lender receives a share of the profits of the business in lieu of interest, or a rate of interest dependent upon the profits. Any security is not affected (*Partnership Act*, 1890, S. 2 [3]).

(*b*) A share of the profits of a business, whether by way of annuity or otherwise, due to a vendor as consideration for the sale by him of the goodwill of the business. Any security is unaffected (*Partnership Act*, 1890, S. 2 [3 (*e*)]).

(*c*) Money or other estate lent or entrusted by a husband to his wife for the purposes of her trade or business (S. 36 [1]).

(*d*) Money or other estate lent or entrusted by a wife to her husband for the purpose of any trade or business carried on by him or otherwise (S. 36 [2]).

(*e*) Money or property contributed by limited partners under a limited partnership agreement are postponed to the claims of the ordinary creditors of the partnership (*Limited Partnership (Winding Up) Rules*, 1909, 4 [4]).

(*f*) Claims of trustees of a marriage settlement in which the settler covenants for future payments of money, or future settlements of property in which he had, at the time of making the settlement, no estate or interest [S. 42 [2]).

Secured Creditors.—By Rule 5 of the second Schedule to the Act of 1914, every creditor is required to state in his affidavit of proof whether he is or is not a secured creditor. By the *Bankruptcy (Amendment) Act*, 1926, S. 11, a creditor who omits to state that he is secured shall surrender his security, unless the Court allows him to amend his affidavit on such terms as to repayment of any dividends or otherwise as the Court may consider just

A secured creditor is one who holds a mortgage, charge, or lien on any property of the bankrupt as security for the debt due to him. Such a creditor may ignore the bankruptcy altogether and realise the security, accounting to the Trustee for any surplus remaining after recovery of the amount of the debt with interest and the expense of realising the security. Or he may adopt one of the three courses following:—

(*a*) Surrender his security and prove for the whole debt.

(*b*) Realise his security and prove for any balance that remains undischarged.

(*c*) Estimate the value of his security and prove for the balance

If the creditor adopts the last-mentioned course, (*c*) above, the Trustee may redeem the security at the creditor's valuation; or, if he is dissatisfied with the valuation, require the property to be sold, in which case the creditor can prove for any balance remaining after crediting the proceeds of sale. A secured creditor may at any time, by notice in writing, require the Trustee to elect whether he will or will not exercise his right to redeem the security, or to require the property to be sold, and if the Trustee does not within six months of the receipt of the notice signify to the creditor, in writing, that he will exercise either right, then the property vests in the creditor at the estimated value that he has placed upon it.

If the security rests upon the estate of a third person, *e.g.* a guarantor, or is held on a separate estate against a joint debt, the security need not be valued, and the creditor may prove for the whole debt.

Execution Creditors.—A creditor who has obtained judgment against a debtor may enforce the judgment by levying execution on the land or goods of the debtor, or by attaching debts due to the debtor. No such execution or attachment is valid against the O.R. or the Trustee unless it is completed before the date of the R.O., and before the judgment creditor has had notice of the commission by the debtor of an available act of bankruptcy, or that a bankruptcy petition has been presented by the debtor, or by his creditor or creditors.

Partnership.—Firms, like individuals, are subject to the bankruptcy laws, but limited companies are not. Limited companies are wound up under the *Companies Act*, 1948, and the *Companies (Winding-up) Rules*, 1949. A petition may be presented, and a R.O. be made against a firm in the firm name, but the adjudication order is made against each partner separately. The partners must prepare a statement of affairs for the partnership, and each partner must prepare a statement of his separate affairs. There is a joint estate of the partnership assets primarily liable for the firm's debts, and the separate estate of each partner primarily liable for each partner's separate debts. The joint partnership estate is first applied in payment of the joint partnership debts, and each partner's separate estate is first applied in payment of his separate debts. Any surplus on a partner's separate estate goes into the joint estate, if there is a deficiency on the joint estate, but the intention to transfer such a surplus must first be advertised in the *Gazette*. Should there be a surplus on the joint estate, it is divided among the separate estates in proportion to the right and interest of each partner in the joint estate. Where a R.O. is made against a firm, both the joint and separate creditors are summoned to the first meeting of creditors. The Trustee appointed by the joint creditors acts also as Trustee for the separate estates.

The bankruptcy of one partner of a firm does not necessarily involve the bankruptcy of the firm, but, in the absence of any agreement to the contrary, it dissolves the partnership.

Discharge of Bankrupt.—On conclusion of his public examination, a bankrupt may apply for an order of discharge from bankruptcy. The O.R. gives notice to every creditor of such an application. The Court may at its discretion grant, refuse, or suspend the order, or it may impose conditions prior to granting the order, such as that the bankrupt shall consent to judgment for a fixed amount, the judgment to be satisfied out of the after-acquired property of the bankrupt.

If the bankrupt has been guilty of felony, or any misdemeanour, as specified in SS. 154–158, that will constitute grounds for refusal. The order may also be refused, or, if not refused, may be suspended, where the bankrupt is shown to have failed to keep proper books, or to have continued to trade knowing himself to be insolvent, or to have contributed to his bankruptcy by rash speculation, or unjustifiable extravagance in living, or gambling, or culpable neglect of his business, or where any of the other facts specified in SS. 26 (3) and S. 27 have been proved against him.

Under the Act of 1914, the failure to keep proper books of account might entail the refusal, or the suspension of the order of discharge, or the grant of it only upon terms. It did not amount to a misdemeanour, which may entail not only refusal of the order of discharge, but prosecution as well, unless the bankrupt had previously been adjudged bankrupt, or had previously made a composition or arrangement with his creditors. Now, by the *Bankruptcy (Amendment) Act*, 1926, a person who for the first time becomes bankrupt, or in respect of whose estate a R.O. has been made will, after June 16, 1928, be guilty of a misdemeanour if, having been engaged in any trade or business during any period in the two years immediately preceding the date of the presentation of the bankruptcy petition, he has not kept proper books throughout that period and throughout any further period in which he was so engaged between the date of the presentation of the petition and the date of the R.O., or has not preserved all books of account so kept. The only escape from penalty will be proof that the omission to keep proper books is honest and excusable in the circumstances in which he traded, or where, in the case of a first R.O., the unsecured liabilities do not exceed £500, and in any other case £100.

No. 34.—STATEMENT OF AFFAIRS.

(*Title.*)

To the Debtor,—

You are required to fill up, carefully and accurately, this sheet, and such of the several sheets A, B, C, D, E, F, G, H, I, J, and K,* as are applicable, showing the state of your affairs on the day on which the Receiving Order was made against you, viz. the .... day of ....19... Such sheets, when filled up, will constitute your Statement of Affairs, and must be verified by oath or declaration.

Gross Liabilities.			Liabilities (as stated and estimated by Debtor).				Expected to Rank.			Assets (as stated and estimated by Debtor).	Estimated to Produce.		
£	s.	d.					£	s.	d.		£	s.	d.
			Unsecured creditors as per List A . .							Property as per List H, viz.:—			
			Creditors fully secured as per List B . .	£	s.	d.				(*a*) Cash at bankers			
			Estimated value of securities . . .							(*b*) Cash in hand			
			Surplus							(*c*) Cash deposited with solicitor for costs of petition .			
			Less amount thereof carried to Sheet C .							(*d*) Stock-in-trade (cost £)			
			Balance thereof to *contra* . . .							(*e*) Machinery			
			Creditors partly secured as per List C . .							(*f*) Trade fixtures, fittings, utensils, etc.			
			Less estimated value of securities . .	£						(*g*) Farming stock			
			Liabilities on bills discounted other than debtor's own acceptances for value as per List D, viz.:—							(*h*) Growing crops and tenant right			
										(*i*) Furniture			
										(*j*) Life policies			
										(*k*) Stocks and shares			
										(*l*) Reversionary or other interests under wills . .			
										(*m*) Other property, viz.:—			
										Total as per List H			

	£	s.	d.	
On accommodation bills as drawer, acceptor, or indorser				
On other bills as drawer or indorser . .				
	£			
Of which it is expected will rank against the estate for dividend . . .				
Contingent or other liabilities as per List E	£	:	:	
Of which it is expected will rank against the estate for dividend				
	£	s.	d.	
Creditors for rent, etc., recoverable by distress as per List F . . .				
Creditors for rates, taxes, wages, etc., payable in full as per List G . .				
Sheriff's charges payable under S. 41 of the Act, estimated at				
Deducted *contra*	£			
† Surplus explained in Statement K				
				£

	£	s.	d.	
Book debts as per List I, viz. :—				
Good				
Doubtful				
Bad				
	£			
Estimated to produce				
Bills of exchange or other similar securities on hand as per List J				
Estimated to produce . .	£	:	:	
Surplus from securities in the hands of creditors fully secured (*per contra*)				£
Deduct creditors for distrainable rent and for preferential rates, taxes, wages, sheriff's charges, etc. (*per contra*) .				£
† Deficiency explained in Statement K				£

I .... of .... in the County of .... make oath and say that the above statement and the everal lists hereunto annexed marked .... are, to the best of my knowledge and belief, a full, true, and complete statement f my affairs on the date of the above-mentioned receiving order made against me.

Sworn at ....
in the County of ....
this .... day of ...., 19...,
Before me, ...

(*Signature*) ....

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* Sheet L should be substituted for any one or more of such of the sheets named as will have to be returned blank.

† Strike out words which do not apply.

The new Act further provides that, except in respect of retail sales made to the actual consumer, proper accounts must be kept of all sales and purchases with sufficient detail of buyers and sellers to enable the goods and the buyers and sellers thereof to be identified. This is an attempt to prevent "long-firm" frauds. The Act gives the Court unfettered freedom regarding the period during which a bankrupt's discharge may be suspended.

Undischarged Bankrupt.—It is important that a bankrupt should obtain his discharge.

Where an undischarged bankrupt either alone or jointly with any other person obtains credit to the extent of £10 or upwards from any person without informing that person that he is an undischarged bankrupt; or engages in any trade or business under a name other than that under which he was adjudicated bankrupt without disclosing to all persons with whom he enters into any business transaction the name under which he was adjudicated bankrupt: he shall be guilty of a misdemeanour (S. 155).

Official Forms.—The prescribed forms which the debtor must employ when submitting his Statement of Affairs are shown on pp. 705–712.

Illustration.—From the following particulars prepare the Statement of Affairs and the Deficiency Account of S. P. Endthrift. The Deficiency Account is to start at the commencement of business. The R.O. was dated December 31, 1950.

Business Balances, December 31, 1950:—

Capital Account, £635; Trade Creditors, £2,500; Expenses, £140; Rent (one year), £300; Loan on Security of Freehold House, £1,000; Bank Overdraft, £200; Bills Payable, £1,000; Liability on Bills Discounted, £1,500 (Estimated to rank, £350); Income Tax due, 1948–49, £200, 1949–50, £50; Rates (six months), £55; Wages of Workmen—Brown (six weeks), £36, Jones (four weeks), £24; Salary of Clerk (three months), £260; Cash in hand, £50; Bills Receivable, £190 (Estimated to produce £150); Freehold House, £1,500; Stock at Cost, £2,000 (Valued at £1,200); Trade Fixtures at Cost, £300 (Valued at £100); Debtors: Good, £810, Doubtful, £400 (Estimated to produce 25%), Bad, £1,010.

Private Assets and Liabilities: Household Furniture, £480; Household Debts, £90; Life Policy for £2,000, Surrender Value, £150, held by Bank as security for overdraft.

The business was commenced on January 1, 1948, with a Capital of £3,000. Profit for 1948, £306; Loss for 1949, £292; Loss for 1950, £779. Drawings were £600 per annum. (*Solution*, pp. 711–712.)

No. 34.

A.—UNSECURED CREDITORS.

The Names to be arranged in alphabetical order and numbered consecutively, Creditors for £10 and upwards being placed first.

No.	Name.	Address and Occupation.	Amount of Debt.	Date when Contracted.		Consideration.
				Month.	Year.	
			£ s. d.			

Signature ....

Dated .... 19..

Notes.—1. When there is a contra account against the creditor, less than the amount of his claim against the estate, the mount of the creditor's claim and the amount of the contra account should be shown in the third column, and the balance only e inserted under the heading "Amount of Debt," thus:

	£ s. d.
Total amount of claim .	
Less contra account	

o such set off should be included in Sheet I.

2. The particulars of any bills of exchange and promissory notes held by a creditor should be inserted immediately below the ame and address of such creditor.

No. 34.

B.—CREDITORS FULLY SECURED.

No.	Name of Creditor.	Address and Occupation.	Amount of Debt.			Date when Contracted.		Consideration.	Particulars of Security.	Date when given.	Estimated Value of Security.			Estimated Surplus from Security.		
						Month.	Year.									
			£	s.	d.						£	s.	d.	£	s.	d.

Signature ....

Dated .... 19...

No. 34.

C.—CREDITORS PARTLY SECURED.

No.	Name of Creditor.	Address and Occupation.	Amount of Debt.			Date when Contracted.		Consideration.	Particulars of Security.	Month and Year when given.	Estimated Value of Security.			Balance of Debt Unsecured.		
						Month.	Year.									
			£	s.	d.						£	s.	d.	£	s.	d.

Signature ....

Dated .... 19...

No. 34.

D.—LIABILITIES OF DEBTOR ON BILLS DISCOUNTED OTHER THAN HIS OWN ACCEPTANCES FOR VALUE.

No.	Acceptor's Name, Address, and Occupation.	Whether liable as Drawer or Indorser.	Date when due.	Amount.						Holder's Name, Address, and Occupation (if known).	Amount expected to rank against Estate for Dividend.		
				Accommodation Bills.			Other Bills.						
				£	s.	d.	£	s.	d.		£	s.	d.

Signature ....

Dated .... 19...

No. 34.

E.—CONTINGENT OR OTHER LIABILITIES.

(Full particulars of all Liabilities not otherwise scheduled to be given here.)

No.	Name of Creditor or Claimant.	Address and Occupation.	Amount of Liability or Claim.			Amount expected to rank for Dividend.			Date when Liability incurred.		Nature of Liability.
			£	s.	d.	£	s.	d.	Month.	Year.	

Signature ....

Dated .... 19...

No. 34.

F.—CREDITORS FOR RENT, ETC., RECOVERABLE BY DISTRESS.

No.	Name of Creditor.	Address, and Occupation.	Nature of Claim.	Period during which Claim accrued due.	Date when due.	Amount of Claim.			Amount recoverable by distress.			Difference ranking for Dividend (to be carried to List A).		
						£	s.	d.	£	s.	d.	£	s.	d.

Signature ....

Dated .... 19...

No. 34.

G.—PREFERENTIAL CREDITORS FOR RATES, TAXES, AND WAGES.

No.	Name of Creditor.	Address and Occupation.	Nature of Claim.	Period during which Claim accrued due.	Date when due.	Amount of Claim.			Amount payable in full.			Difference ranking for Dividend (to be carried to List A).		
						£	s.	d.	£	s.	d.	£	s.	d.

Signature ....

Dated .... 19...

No. 34.

H.—PROPERTY.

Full particulars of every description of Property in possession and in reversion as defined by Section 167 of the Act, not included in any other list, are to be set forth in this list.

Full Statement and Nature of Property.	Estimated to produce.		
	£	s.	d.
(a) Cash at bankers			
(b) Cash in hand			
(c) Cash deposited with solicitor for costs of petition			
(d) Stock-in-trade at			
(e) Machinery at . . . . . Cost £ : :			
(f) Trade fixtures, fittings, utensils, etc., at			
(g) Farming stock at			
(h) Growing crops and tenant right at			
(i) Household furniture and effects at			
(j) Life policies			
(k) Stocks and shares			
(l) Reversionary or other interests under wills, etc.			
(m) Other property (state particulars), viz.			

Signature ....

Dated .... 19...

No. 34.

I.—DEBTS DUE TO THE ESTATE.

No.	Name of Debtor.	Residence and Occupation.	Amount of Debt.									Folio of Ledger or other Book where Particulars to be found.	When Contracted.		Estimated to produce.			Particulars of any Securities held for Debt.
			Good.			Doubtful.			Bad.				Month.	Year.				
			£	s.	d.	£	s.	d.	£	s.	d.				£	s.	d.	

Signature ....

Dated .... 19...

Note.—If any debtor to the estate is also a creditor, *but for a less amount than his indebtedness*, the gross amount due to the tate and the amount of the contra account should be shown in the third column, and the balance only be inserted under the ading " Amount of Debt " thus :

	£	s.	d.
Due to estate			
Less contra account			

No such claim should be included in Sheet A.

No. 34.

J. BILLS OF EXCHANGE, PROMISSORY NOTES, Etc., AVAILABLE AS ASSETS.

No.	Name of Acceptor of Bill or Note.	Address, etc.	Amount of Bill or Note.	Date when due.	Estimated to produce.	Particulars of any Property held as security for Payment of Bill or Note.
			£ s. d.		£ s. d.	

Signature .... *Dated* .... 19...

No. 34.

K. DEFICIENCY (OR SURPLUS) ACCOUNT.

	£	s.	d.	£	s.	d.
Excess of assets over liabilities on the *........ day of .... 19... (if any)						
Net profit (if any) arising from carrying on business from the *............ day of .... 19... to date of Receiving Order, after deducting usual trade expenses						
Income or profit from other sources (if any) since the *............ day of .... 19...						
Gifts from relations and others						
‖ Deficiency as per Statement of Affairs						
Total amount to be accounted for ¶				£		

	£	s.	d.	£	s.	d.
Excess of liabilities over assets on the *........... day of .... 19... (if any)						
Net loss (if any) arising from carrying on business from the *............ day of .... 19..., to date of Receiving Order, after charging against profits the usual trade expenses						
Bad debts (if any) as per Schedule I †						
Depreciation of stock in trade						
Depreciation of machinery						
Depreciation of trade fixtures, fittings, etc.						
Expenses incurred since the *............ day of .... 19..., other than usual trade expenses, viz. household and personal expenses of self and ‡						
§ Other losses and expenses (if any)						
‖ Surplus as per Statement of Affairs						
Total amount accounted for ¶				£		

Signature .... *Dated* .... 19...

* This date should be twelve months before date of receiving order, or such other time as Official Receiver may have fixed.

† This Schedule must show when debts were contracted.

‡ Add "wife and children" (if any), stating number of latter.

§ Here add particulars of other losses or expenses (if any), including liabilities (if any) for which no consideration received.

‖ Strike out words which do not apply.

¶ These figures should agree.

Re S. P. ENDTHRIFT.

STATEMENT OF AFFAIRS

AT DECEMBER 31, 1950, DATE OF RECEIVING ORDER.

Gross Liabilities.	Liabilities (as stated and estimated by Debtor).		Expected to rank.
£ s. d.		£ s. d.	£ s. d.
4,050 0 0	Unsecured Creditors as per List A		4,050 0 0
1,000 0 0	Creditors fully secured as per List B	1,000 0 0	
	Estimated value of securities	1,500 0 0	
	Surplus to contra	500 0 0	
200 0 0	Creditors partly secured as per List C	200 0 0	
	Less estimated value of securities	150 0 0	50 0 0
1,500 0 0	Liabilities on Bills discounted other than Debtor's own acceptances for value as per List D	1,500 0 0	
	Expected to rank		350 0 0
	Creditors for rent, etc., recoverable by distress as per List F	150 0 0	
	Creditors for rates, taxes, wages, etc., payable in full as per List G	515 0 0	
665 0 0	Deducted contra	665 0 0	
£7,415 0 0			£4,450 0 0

Assets (as stated and estimated by Debtor).		Estimated to produce.
		£ s. d.
Property as per List H, viz.:		
Cash in hand		50 0 0
Stock-in-trade (cost £2,000)		1,200 0 0
Trade fixtures		100 0 0
Furniture		480 0 0
Total as per List H		1,830 0 0
Book debts as per List I, viz.:		
Good		810 0 0
Doubtful	£ s. d. 400 0 0	
Bad	1,010 0 0	
	£1,410 0 0	
Estimated to produce		100 0 0
Bills of Exchange or other similar securities as per List J	£190 0 0	
Estimated to produce		150 0 0
Surplus from securities in the hands of creditors fully secured (per contra)		500 0 0
		3,390 0 0
Deduct creditors for distrainable rent, and for preferential rates, taxes, wages, etc. (per contra)		665 0 0
		2,725 0 0
Deficiency as explained in statement, List K		1,725 0 0
		£4,450 0 0

LIST K DEFICIENCY OR SURPLUS ACCOUNT

	£	£		£	s.	d.
Excess of Assets over Liabilities on January 1, 1948		[illegible]	Net Loss arising from carrying on of business from January 1, 1948, to [illegible], 1949, after deducting the usual Trade Expenses—			
Net Profit arising from the carrying on of business from January 1, 1948, to [illegible], 1949, after deducting the usual Trade Expenses		[illegible]	For the year 1948 £[illegible]			
Increase of Profit from other sources since January 1, 1948:			For the year 1949 [illegible]	[illegible]	[illegible]	[illegible]
Private Assets brought in:			Bad Debts as per Schedule I	[illegible]	[illegible]	[illegible]
Life Policy	[illegible]		Depreciation of Stock in trade	[illegible]	[illegible]	[illegible]
Household Furniture	[illegible]		Depreciation of Trade Fixtures	[illegible]	[illegible]	[illegible]
Deficiency as per Statement of Affairs		1,725	Expenses since January 1, 1948, other than the usual Trade Expenses, viz. Household expenses of self and wife and three children	1,[illegible]	0	0
			Other losses and expenses—			
			Estimated Loss on Bill Receivable Discounted	35[illegible]	0	0
			Estimated loss on realisation of Bills Receivable	[illegible]	0	0
		£[illegible]		£5,[illegible]	0	0

Notes.—(1) The Unsecured Creditors are composed of :—

	£	s.	d.
Trade	2,500	0	0
Expenses	140	0	0
Rent (six months)	150	0	0
Bills Payable	1,000	0	0
Income Tax, 1949–50	50	0	0
Salary in excess of £200	60	0	0
Household Debts	90	0	0
	£4,050	0	0

(2) The Preferential Creditors are restricted as follows :—

	£	s.	d.
Rent (only six months recoverable by distraint)	150	0	0
Income Tax (only one year preferential, but any one year may be chosen), 1948–49	200	0	0
Brown, workmen's wages	36	0	0
Jones	24	0	0
Salary (not to exceed £200 in respect of any clerk or servant)	200	0	0
Rates	55	0	0
	£665	0	0

The balances are included with the unsecured creditors.

(3) Subject to the costs of the bankruptcy, there is £2,725 available to meet the claims of unsecured creditors, amounting to £4,450.

THE TRUSTEE.

Appointment.—After the debtor has been adjudicated bankrupt, the O.R. acts as Trustee until some other person is appointed so to act. Any person may be appointed by the creditors by ordinary resolution, or they may leave the appointment to the C. of I. The Board of Trade may object to the person appointed if his connection with the debtor, or any creditor, or his personal interest in the debtor's estate would make it difficult for him to act impartially; or if he has previously been removed from a trusteeship for misconduct; or if his appointment was irregular. Should the creditors fail to appoint a Trustee, the Board of Trade may do so, but the creditors or the C. of I. may, at any time, substitute their own for the Board's nominee. The Trustee's appointment must be gazetted and advertised in a local paper. A Trustee is required to give such security as the Board of Trade may require, and with the creditors' consent the premium on the guarantee bond may be charged against the estate. The amount of the bond may be reduced from time to time with the consent of the Board of Trade.

Duties.—The Trustee's duties are to take possession of the debtor's property, realise it, and apply the proceeds in paying: (*a*) the costs of the bankruptcy, including his own remuneration, (*b*) the creditors, and (*c*) returning any surplus to the debtor.

Powers.—By S. 54, where any part of the property of the bankrupt consists of land of any tenure burdened with onerous covenants, of shares or stock in companies, of unprofitable contracts, or of any other property that is unsaleable, or not readily saleable, by reason of its binding the possessor thereof to the performance of any onerous act, or to the payment of any sum of money, the trustee, notwithstanding that he has endeavoured to sell or has taken possession of the property, or exercised any act of ownership in relation thereto, may, by writing signed by him, at any time within twelve months after the first appointment of a trustee, disclaim the property; provided that where any such property has not come to the knowledge of the trustee within one month after such appointment, he may disclaim such property at any time within twelve months after he has become aware thereof or such extended period as may be allowed by the Court. This power is known as the *right of disclaimer*, and its effect is to determine, as from the date of disclaimer, the bankrupt's rights and liabilities in respect of the property disclaimed, and also to discharge the trustee from all personal liability in respect of the property as from the date when the property vested in him.

By S. 55, a Trustee has power to sell the bankrupt's property by auction or private contract; to execute powers of attorney, deeds, and other instruments; to deal with any entailed property to which the bankrupt is beneficially entitled in the same manner as the bankrupt might have dealt with it; to apply to the Court for direction in cases of need, etc., as set out in the section.

By S. 56, the Trustee may exercise other powers, but only with the permission of the C. of I. These include power to carry on the bankrupt's business so far as it may be necessary for the beneficial winding-up of the estate; to bring or defend actions relating to the bankrupt's property; to employ a solicitor or other agent to take any proceedings or do any business sanctioned by the C. of I.; to compromise with creditors, etc., as detailed in the section.

Remuneration.—The creditors, by ordinary resolution, may fix the Trustee's remuneration, or they may leave it to the C. of I. It must take the form of a commission or percentage, of which one part is payable on the amount realised by the Trustee, after deducting any sums paid to secured creditors out of the proceeds of their securities, and the other part on the amount distributed in dividends.

Dividends.—The first dividend must be declared and distributed within four months following the conclusion of the first meeting of creditors, unless the Trustee satisfies the C. of I. that there is sufficient reason for postponement. Subsequent dividends must, in the absence of adequate reasons for not doing so, be declared and distributed at intervals of not less than six months.

Final Dividend and Release.—When the Trustee has realised all the property of the bankrupt, or so much thereof as, in the joint opinion of himself and the C. of I., can be realised without needlessly protracting the trusteeship, he must declare a final dividend. Having distributed this dividend, or whenever for any other reason his trusteeship terminates, *e.g.* by resignation, or removal by the Board of Trade, he may apply for his release. Before doing so, he must give notice to all creditors who have proved their debts, and must send with the notice a summary of his receipts and payments as Trustee. The order granting the release must be gazetted, and is not effectual until the Trustee has delivered to the O.R. all books, papers, documents, and accounts relating to the bankruptcy.

Unclaimed dividends must, after the expiration of six months, be paid into the Bankruptcy Estates Account at the Bank of England.

Fraudulent Preference.—One of the objects of bankruptcy law is to secure a rateable division of the debtor's estate amongst his creditors by preventing a debtor from paying one creditor to the prejudice of others. So every payment made, or transfer of, or charge on, property given to a creditor by a debtor who is unable to pay his debts as they become due is void against the Trustee if the debtor is adjudged bankrupt on a petition presented within three months from the date when the payment was made, or the transfer or charge was executed. To make such a payment, transfer, or charge void, the dominant motive of the debtor must be to give a preference. If the creditor puts pressure on the debtor by taking legal proceedings against him, the Trustee will not be able to set aside the payment; nor is there a fraudulent preference where it is the debtor's object to save himself from exposure or prosecution, or to revive an undisputed debt, or make good a breach of trust.

ESTATE CASH BOOK.

Date.	Particulars.	Receipts.																	
		Total.			Drawn from Bank.			Debts Collected.			Property Realised.			Receipts from Securities held by Creditors.			Other Receipts.		
		£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.

ESTATE CASH BOOK—*continued.*

Payments.																		
Date.	Particulars.	Voucher Nos. (in red).	Total.			Paid into Bank.			Costs of Realisation.									
									Board of Trade and Court Fees.			Law Costs of Petition (including £5 Stamp).			Law Costs after Receiving Order.		
			£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.

ESTATE CASH BOOK—*continued.*

PAYMENTS—*continued.*																													
COSTS OF REALISATION—*continued.*																													
Commission on Realisation and Distribution.						Charges of Auctioneer, Accountant, Shorthand Writer, etc., as taxed.			Notices in *Gazette* and Local Paper.			Incidental Expenses, including Possession.			Allowance to Debtor.			Preferential Creditors (Section 40) and Rent.			Payments to redeem Securities.			Dividends Paid.			Other Payments.		
Board of Trade.			Trustees.																										
£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*

(*Trading Account.*)

THE BANKRUPTCY ACT, 1914.

IN THE HIGH COURT OF JUSTICE.

IN BANKRUPTCY.

No. ...... of 19..

Re ...., a Bankrupt.

..............................., the Trustee of the property of the Bankrupt in acco
with the Estate.

DR. Cr

Date.	Receipts.	£	s.	d.	Date.	Payments.	£	s.

......................., Trustee.
Date .... 19...

We have examined this Account with the vouchers, and find the same correc and we are of opinion that the expenditure has been proper.

....
.... Committee of Inspection.
....

BOOKS AND ACCOUNTS.

Record Book.—Prior to the appointment of the Trustee, th O.R. will open the *Record Book*, for the purpose of recording all resol tions and minutes of meetings, copies of notices and other document and all such papers, except confidential documents, as may be necessar to furnish a true history of the administration of th

(*Statement to accompany Notice of Dividend and Application for Release.*)

THE BANKRUPTCY ACT, 1914.

IN THE HIGH COURT OF JUSTICE.

IN BANKRUPTCY.

No. ...... of 19...

IN THE MATTER OF ...., of ...., under Receiving Order dated ....

STATEMENT showing the position of the estate at date of declaring the first dividend.

Dr.	Estimated to produce per Debtor's Statement.			Receipts.			Cr.				Payments.		
	£	s.	d.	£	s.	d.					£	s.	d.
To Total Receipts from date of receiving order, viz.: * .							By Board of Trade and Court Fees (including stamp of £5 on petition) .						
Receipts per Trading Account								£	s.	d.			
Other Receipts . . .							,, Law Costs . . .						
							,, Trustee's remuneration as fixed by the creditors † .						
							,, Other costs . . .						
Total . . .	£			£									

Less—	£	s.	d.				,, Allowance to debtor . . .						
Deposit returned to Petitioner							,, Creditors, viz. :—	£	s.	d.			
Payments to redeem securities							‡ Preferential .						
Costs of execution . .							‡ Unsecured § dividend now declared of ...... in the £ on .						
Payments per Trading Account							Dividends previously declared . . .						
Net realisations				£			Balance						
				£							£		

By S. 82 (2) of the *Bankruptcy Act*, 1914, it is provided that "if one-fourth in number or value of creditors dissent from the resolution, or the bankrupt satisfies the Board of Trade that the remuneration is unnecessarily large, the Board of Trade shall fix the amount of the remuneration."

Assets not yet realised estimated to produce ....

||

Creditors can obtain any further information by inquiry at the Office of the Trustee.

Dated this .... 19...

.... Trustee.

....

....

* State particulars under the several headings specified in the Debtor's Statement of Affairs.
† "Creditors" or "Committee of Inspection" or "Board of Trade," or as the case may be.
‡ Insert number of creditors. § "1st," or as the case may be.
|| Add any special remarks the Trustee thinks desirable.

Note.—When this Statement accompanies a declaration of a second or subsequent dividend, it shall incorporate the figures of he preceding Statement or Statements under their respective headings.

Cash Book.—The O.R. will also have opened the Cash Book, a uling of which is shown on pp. 715–716. All moneys received must be paid into the *Bankruptcy Estates Account* at the Bank of England, unless the Board of Trade, on the application of the C. of I., allows an account to be opened at a local bank.

Trading Account.—If the business of the debtor is carried on, a Trading Account must be kept. This is on a cash basis as shown on p. 717. The weekly totals of this account are incorporated in the "Other Receipts" and "Other Payments" columns of the Cash Book.

Audit of Trustee's Accounts.—The Trustee must submit his books, accounts, and vouchers to the C. of I. at least once every three months, and the Committee must audit the Cash Book and append its certificate thereto on the day of auditing.

At the expiration of six months from the date of the R.O., and at the expiration of every succeeding six months thereafter until his release, the Trustee must transmit to the Board of Trade for audit a copy of the Cash Book in duplicate for such periods, together with the necessary vouchers and copies of the audit certificates of the C. of I. The Trustee is also required to forward at the first audit of his accounts by the Board of Trade an office copy of the front sheet (the summary) of the debtor's Statement of Affairs, and of sheets B, C, F, G, and H, showing thereon, in red ink, the amounts received, and explaining the cause of the non-realisation of such assets as may remain unrealised. At each audit, the Trustee must forward a report on the position of the estate.

Accounts to Creditors.—A statement showing the position of the estate must be sent to each creditor together with the notice declaring a dividend. A final statement of the position of the bankruptcy also accompanies the notice to creditors of the Trustee's intention to apply for his release, and usually it is joined to the notice declaring a final dividend. Any creditor may, with the concurrence of one-sixth of the creditors (including himself), at any time call upon the Trustee, or O.R., to furnish and transmit to the creditors a statement of the Accounts up to the date of such notice. The official form appears on pp. 718–719.

Illustration.—In the matter of the estate of S. P. Endthrift (*see* p. 711), the Trustee was authorised by the C. of I. to postpone the declaration of a dividend until the whole estate had been realised. A first and final dividend was accordingly declared on August 30, 19... The Trustee's remuneration was fixed at 3% on the amount realised and 2% on the amount distributed in dividend. On p. 721 is given the statement accompanying the notice of the final dividend and the application for release.

TRUSTEE'S FINAL SUMMARY OF RECEIPTS AND PAYMENTS.

	Estimated to produce as per Debtor's Statement. £	s.	d.	Realised to date. £	s.	d.
To Total Receipts from date of Receiving Order, viz. :—						
,, Deposit on Petition				5	0	0
,, Cash in hand	50	0	0	50	0	0
,, Cash deposited with Solicitor						
,, Stock-in-trade	1,200	0	0	1,110	0	0
,, Fixtures and Fittings	100	0	0	135	0	0
,, Book Debts	910	0	0	1,005	0	0
,, Bills of Exchange	150	0	0	160	0	0
,, Household Furniture	480	0	0	390	0	0
,, Surplus from Secured Creditors	500	0	0	500	0	0
,, Receipts as per Trading Account						
,, Other Receipts						
Total	£3,390	0	0	£3,355	0	0
Less—						
Deposit returned to Petitioner	5	0	0			
Payments to redeem Securities						
Cost of Execution						
Payments as per Trading Account				5	0	0
Net Realisations				£3,350	0	0
				£3,350	0	0

	£	s.	d.	Payments. £	s.	d.
By Board of Trade and Court Fees (including Stamp on Petition)				65	0	0
,, Law Costs of Petition	£10	0	0			
,, Other Law Costs	15	0	0	25	0	0
,, Trustee's Remuneration as fixed by the Committee of Inspection, viz. :—						
3% on £3,300 (assets realised)	£99	0	0			
2% on £2,500 (assets distributed in dividend)	50	0	0	149	0	0
,, Special Manager's Charges						
,, Person appointed to assist Debtor under Sec. 74				5	0	0
,, Auctioneer's Charges as taxed				29	0	0
,, Other taxed Costs						
,, Costs of Possession						
,, Costs of Notices in *Gazette*				4	0	0
,, Incidental Outlay				19	0	0
Total Cost of Realisation				296	0	0
,, Allowance to Debtor				50	0	0
,, Creditors :—						
Preferential	£504	0	0			
Unsecured	2,500	0	0	3,004	0	0
Dividend now declared of 10*s*. 5*d*. in the £ on £4,800.						
N.B.—The debtor's estimate of the amount expected to rank for dividend was £4,411.						
				£3,350	0	0

By Sec. 82 (2) of the *Bankruptcy Act*, 1914, it is provided that "if one-fourth in number of or value of creditors dissent from he resolution, or the bankrupt satisfies the Board of Trade that the remuneration is unnecessarily large, the Board of Trade shall x the amount of the remuneration."

Creditors can obtain any further information by inquiry at the Office of the Trustee.

Dated this .... day of ...., 19...

1816, East Street, London, E.C.1. .... Trustee

DEEDS OF ARRANGEMENT.

Arrangements are frequently made between insolvent debtors and their creditors without invoking the aid of the bankruptcy laws. The object of these arrangements is to avoid the publicity, expense, and stigma of bankruptcy proceedings.

Usually, a formal deed is drawn up and a Trustee appointed. The usual terms of a *Deed of Assignment* provide that the debtor shall assign all his property, or so much thereof as is specified in the deed, to a trustee in trust to realise the property, pay the expenses of realisation, and divide the balance rateably, as in bankruptcy, among the creditors assenting to the deed. In consideration, the creditors undertake to release the debtor from the unpaid balance of their claims. Or the agreement may take the form of a *Deed of Composition*, under which the creditors agree to accept a portion only of the amount due to them, payable by stated instalments, and agree not to sue unless default is made, and to release the debtor from his liabilities on payment.

Only such creditors as assent to deeds of this kind are bound by them, whereas bankruptcy automatically concerns all creditors whose debts are provable in the bankruptcy. Moreover, as the execution of these deeds usually amounts to an act of bankruptcy on the part of the debtor, any creditor whose debt exceeds £50, and who has not assented to the deed, can bring it to naught by presenting a bankruptcy petition against the debtor. If a R.O. is made within three months of the execution of the deed, the deed becomes void, and the Trustee under the deed must account to the Trustee under the bankruptcy for all moneys, etc., received on behalf of the debtor's estate.

Deeds of Arrangement are governed by the *Deeds of Arrangement Act*, 1914, and the *Rules* made pursuant thereto. The Act provides that a D. of A. is void unless it is registered with the Registrar of Bills of Sale within seven clear days after the first execution thereof by the debtor or any creditor. Further, if the deed is expressed to be, or in fact is, for the benefit of the debtor's creditors generally, it is void unless, within twenty-one days of registration, a majority in number and value of the creditors have assented to the deed.

The Act further provides for the giving of security by the Trustee unless this precaution is dispensed with by a majority in number and value of the creditors.

The Trustee must annually transmit to the Board of Trade, within thirty days of the anniversary of the date of the registration of the deed, an account of his receipts and payments. Where the business of the debtor is carried on, he must keep a separate account of the trading receipts and payments, and carry the totals into the yearly account. Distributions of dividend, or instalments of composition, must be entered in the Trustee's Account in one sum, and be supported by a statement showing the claim of each creditor, and the amount of dividend or composition due to each, distinguishing between those paid and those unpaid.

When a debtor intends to propose a scheme of arrangement or composition to his creditors, it is usual for a Statement of Affairs to be drawn up on similar lines to the Statement of Affairs in bankruptcy, but no official form is prescribed for the statement. When prepared, the statement is submitted to a meeting of the creditors, together with particulars of the scheme proposed. These private schemes must not be confused with schemes officially sanctioned by the Court in bankruptcy. The following is a common form of Statement of Affairs in these cases.

Name ....
Address ....

DEBTOR'S STATEMENT OF AFFAIRS.

Date ....

Liabilities.		£ s. d.	Assets.		£ s. d.
Unsecured Creditors :—			Cash in hand		
Trade			Cash at Bank		
Cash			Stock-in-trade, at cost . . .		
	£ s. d.		Book Debts :—	£ s. d.	
Creditors fully secured			Good . . .		
Estimated Value of Security . .			Doubtful . .		
			Bad . . .		
Surplus to contra	£			£	
	£ s. d.		Estimated to realise		
Creditors partly secured			Plant and Machinery . . .		
Less Estimated Value of Security . .			Trade Fixtures and Fittings . .		
			Household Furniture . . .		
			Life Policies		
Liabilities on Bills discounted, of which it is expected will rank against the Estate for Dividend .			Bills of Exchange or other Securities, estimated to produce . . .		
Contingent or other Liabilities .			Surplus from Securities in hands of Creditors, see contra . . .		
Creditors for Rent, Rates, Taxes, and Wages, deducted from contra Surplus			Other Assets		
			Deduct Preferential Claims, as per contra		
			Deficiency		
		£			£

EXAMINATION QUESTIONS.

1. State the ground on which a person can be made bankrupt, and to what persons the bankruptcy laws apply. (*Royal Society Arts.*)

2. State any three "acts of bankruptcy" upon which a petition can be founded.

3. Summarise the cases in which a debtor commits an act of bankruptcy. (*Royal Society Arts.*)

4. When is the Official Receiver trustee in a bankruptcy? (*Chartered Accountants.*)

5. In what circumstances will an adjudication in bankruptcy follow the making of a receiving order against a debtor? What will be the immediate effect of the adjudication as regards the property of the debtor? (*Chartered Accountants.*)

6. Give specimens of the forms of accounts to be used in the Statement of Affairs required to be filed by a bankrupt. (*Chartered Accountants.*)

7. Describe the differences which exist between a Statement of Affairs and a Balance Sheet. Give a specimen of the former account, and explain how it is prepared. (*Royal Society Arts.*)

8. Sketch the "Summary Sheet" and the "Deficiency Accounts" of the Statement of Affairs. Supposing the debtor shows a surplus of assets over liabilities, is the Deficiency Account still required to be rendered, and how should it be set out? (*Chartered Accountants.*)

9. Robert Blank has filed a petition in bankruptcy. He has prepared a Statement of Affairs which discloses a deficiency of £3,876. Is any further statement necessary? If so, submit a *pro-forma* account based upon figures which explain the above deficiency. (*Royal Society Arts.*)

10. What classes of creditors are entitled to preferred treatment in bankruptcy, and in what order do they rank for payment?

11. Before his bankruptcy the debtor owed £50 to a workman in his employment as compensation for injuries; he also owed £20 for rates, and £10 to his servant for wages. Should the trustee give these debts any priority over ordinary debts, and, if so, in what order should they rank for payment?

12. Distinguish between a deed of arrangement and a scheme of composition in bankruptcy, particularly with reference to the extent of the control to be exercised by the Board of Trade in either case. (*Incorporated Accountants.*)

13. What power have the creditors to accept a composition or scheme after an adjudication of bankruptcy, and what proceedings and consequences follow upon its adoption? (*Incorporated Accountants.*)

14. State the provisions of the *Deeds of Arrangement Act*, 1914, as to: (*a*) the transmission of the trustees' accounts to creditors; and (*b*) the audit of his accounts. (*Incorporated Accountants.*)

15. On what grounds may the Board of Trade object to the appointment of a trustee in bankruptcy, and in what manner may the validity of such objection be tested? (*Incorporated Accountants.*)

16. What power has a trustee in bankruptcy to disclaim any and what portions of the property vested in him? In what manner, and within what time, must such disclaimer be exercised? (*Incorporated Accountants.*)

17. Give a skeleton of the account which a trustee in a bankruptcy must send with the notice of a final dividend. (*Chartered Accountants.*)

18. What books and accounts must be kept by a trustee in bankruptcy, and by whom and how often are they to be audited? (*Chartered Accountants.*)

19. What facts or figures should be shown by the trustee in the Record Book, and how do the *Bankruptcy Rules* provide for its audit and inspection?

20. Give the headings (without rulings) of the Cash Account of a trustee in bankruptcy to be filed with the Board of Trade. State shortly in what manner you would consider the form might be amended or simplified. (*Chartered Accountants.*)

21. A bankrupt wishes to obtain his discharge. State shortly: (*a*) the steps he must take to obtain such an order, and (*b*) the effect of the order when obtained. (*Incorporated Accountants.*)

22. Give a short account of bankruptcy proceedings from the time when they are started until the discharge of the bankrupt. (*Chartered Institute Secretaries.*)

23. Prepare A B's Statement of Affairs from the following particulars: Assets—Cash, £7, Household Furniture, valued at £50; Sundry Debtors (Good, £50; Doubtful, £600 (estimated to realise £300)), £1,500; Investments (estimated to realise £493), £400. Liabilities—Debts: Fully Secured (security expected to realise £1,600), £1,000; Partly Secured (security expected to realise £2,500), £3,000; Unsecured Creditors, £1,800; Last Quarter's Rent, £50; Last Month's Salaries, £100.

The excess of assets over liabilities on January 1, the last occasion when his books were balanced, was £500. A B attributes his insolvency to loss on trading, and places his household expenses since January 1 at £350. Show the dividend which may be expected by the creditors after allowing for £100 costs.

24. What is the position of an undischarged bankrupt as regards obtaining credit and engaging in trade? (*Chartered Accountants.*)

25. X Y Z filed his Petition in Bankruptcy on January 13. Prepare the front sheet of his Statement of Affairs from the following particulars :—

Unsecured Creditors, £36,942; Fully Secured Creditors, £5,000, secured by a Mortgage on the Debtor's Freehold Factory, which he values at £7,500; Partly Secured Creditors, £8,762, secured by the deposit of forty 5%, War Loan Bearer Bonds of £100 each (market price 84$\frac{11}{16}$); Liability as indorser of an Accommodation Bill for £850, expected to rank in full; Rates and Taxes due, £78.

The debtor stated his Assets as follows: Cash in hand, £12; Cash at Bank, £10; Book Debts—Good, £9,652; Doubtful, £3,642, estimated to be worth 7*s*. 6*d*. in the £; Stock-in-Trade, valued at £2,642; Machinery and Plant, valued at £4,241; Life Policy, surrender value, £325; Bill Receivable, estimated to produce £100. (*Royal Society Arts.*)

26. From the undermentioned particulars prepare the Statement of Affairs of W. & Co. as at September 30.

Unsecured Creditors, £13,000; Cash in hand, £50; Bills Receivable, £170, estimated to produce £100; Book Debts—Good, £2,500; Doubtful (estimated to produce £3,750), £5,000; Creditors Partly Secured, £6,000, value of security, £4,000; Creditors Fully Secured, £9,500 (value of security held, £12,000); Stock-in-trade (estimated to produce £3,750), £4,250; Preferential Creditors—Rent, £1,350 (annual rent, £1,200); Manager's Salary (for nine months), £750; Investments, estimated to produce £900; Contingent liability on uncompleted Contract, £1,500. (*Incorporated Accountants.*)

27. From the undermentioned particulars prepare Statement of Affairs and Deficiency Account of A B as at September 30, 19..., for submission to his Creditors:—

Creditors Unsecured, £150,000; Creditors Partly Secured, £80,000; Creditors Fully Secured, £200; Liability on Bills Receivable (estimated to rank in full), £7,000; Mortgage on Freehold Premises, £20,000; Preferential Creditors, £6,000; Debtors—Good, £40,000; Doubtful (estimated to produce £4,000), £20,000; Consignments (good), £10,000; Stock (estimated to produce £20,000), £80,000; Shares (good), £32,000; Cash, £3,000; Freehold Premises (estimated to produce £28,500), £29,000; Machinery (estimated to produce £24,000), £30,000; Fixtures (estimated to produce £3,000), £6,000.

A B's Capital on previous October 1 was £100,000. The profits of the two years were £61,000, and his drawings amounted to £137,200. (*Incorporated Accountants.*)

28. Samuel Hobson, in business in the City, finds himself insolvent. From the various books and papers in his possession the following particulars as to his financial position are forthcoming. Prepare the Statement of Affairs for submission to his creditors and a Deficiency Account in the ordinary form.

Sundry Debtors (Good, £1,280; Doubtful, £2,800, estimated to produce £1,000; Bad, £700), £4,780; Sundry Freehold Houses, etc. (estimated to produce £2,000), £3,300; Shares—1,000 Ordinary Shares in the Cable Telegraph Company, valued at par, £1,000; Mining and Railway Shares (2,500 are held as security by partly secured creditors and the balance by fully secured creditors), £9,450; Loss through the unsuccessful defence of an action at law, £5,420; Business Expenses, £3,200; Creditors: Unsecured, £16,740; Partly Secured, £5,420; Fully Secured, £3,110; Preferential claims for Salaries and Rent, £500; Private Drawings, £1,200; Samuel Hobson Capital Account, £3,800; Cash at Bank, £420; Bills Receivable, good, £800. (*London Chamber Commerce.*)

29. James Micawber became bankrupt. From the following particulars prepare his Statement of Affairs and Deficiency Account: Unsecured Creditors—Trade Debts, £8,500; Household Debts, £160. Trading Profits and Losses—First Year, Profit, £2,000; Second Year, Loss, £1,000; Third Year, Loss, £600; Fourth Year, Profit, £300; Fifth Year, Loss, £2,300. Yearly Drawings, £800; Fully Secured Creditors (holding securities estimated to produce £10,000), £7,000; Liability on Bills Discounted (of which £100 is expected to rank), £1,000; Creditors for Rent, £150; Creditors for Rates, £30; Book Debts (Good, £1,100; Doubtful, £1,000, expected to produce £600; Bad, £180), £2,280; Bills Receivable, good, £650; Cash at Bank and in hand, £15; Stock (estimated to produce £1,750), £2,100; Capital at commencement of first year, £4,983; Household

Furniture (estimated to produce £550), £700; Office Furniture (estimated to produce £100), £168.

30. Prepare from the undermentioned particulars, as on December 31, a Statement of Affairs, in the prescribed form, to present to a meeting of the creditors of S. Brook: Furniture and Fittings, £250, valued at £100; Cash at Bank (Current Account), £10; Cash in hand, £4; Sundry Debtors, £2,500 (Good, £1,000; Doubtful, £1,000, valued at £500; Bad, £500, valued at nil); Bills of Exchange, £300, valued at £100; Stock-in-Trade, valued at £950, less 20%; Household Furniture, valued at £850; Life Policy for £1,500 (surrender value, £550), held by the Bank as security for loan; 500 fully paid shares of £1 each, valued at par, in the Blankshire Biograph Company, Ltd., held as security by R. Brown; Trade Creditors, unsecured, £3,950; Loan from Bankers, £500 (secured as above); Loan from R. Brown, £600 (secured as above); Rent due, £150; Rates, £25; Wages (preferential), £10. (*Royal Society Arts.*)

31. A business carried on under the style of Wood and Smith finds itself in difficulties, and instructs you to prepare a Statement of Affairs for submission to a private meeting of the creditors.

The following particulars are obtained from the books, as at February 1: Unsecured Creditors, £23,000 5*s.* 6*d.*; Loan from A, £2,000; Creditors partly secured, £4,600 (estimated value of security, £4,000); Preferential Claims, £240 12*s.* 6*d.*; Stock-in-trade, £1,500 8*s.*; Cash at Bank, £270 14*s.* 2*d.*; Cash in hand, £65 4*s.* 10*d.*; Fixtures, £400; Debtors: Good, £820; Bad, £72 15*s.* 9*d.*; Doubtful, £41 5*s.*

As regards the separate estates, Wood had no creditors nor assets, and Smith was a limited partner with £1,000 in the business. With respect to the loan A had lent the £2,000 without security and under an arrangement whereby he was to receive interest varying with the profits. (*Incorporated Accountants.*)

32. Henry Jones filed his petition in bankruptcy on June 30. His books showed the following balances:—

	£	£
Cash in hand	10	
Fixtures and Fittings (estimated to produce £80)	250	
Stock-in-trade (estimated to produce £1,200)	1,800	
Sundry Creditors: Open Accounts		2,000
Sundry Creditors: Bills Payable		2,200
Sundry Debtors (Good, £1,000; Doubtful, £2,000, estimated at 50%; Bad, £2,000)	5,000	
Bank Overdraft		1,200
Capital		1,660
	£7,060	£7,060

Liability on bills discounted, £500, £100 expected to rank. His household furniture, etc., was valued at £250. He owned the house he lived in—it was valued at £750—and he had a mortgage on it of £600 at 4%. Interest paid to December 31 previous. Preferential creditors amounted to £35 (included in Sundry Creditors), and £15 for rates on his house.

Prepare a Statement of Affairs. (*Chartered Accountants.*)

33. A finds, by the following summary of assets and liabilities of his business, that he is insolvent, and on October 15 files his own petition in bankruptcy. Prepare his Statement of Affairs for presentation to his creditors.

The Bank's overdraft is secured by the deposit of deeds representing his freehold property (valued for the purpose of the Statement at £6,000), and dock warrants for Stock of the value of £2,383 10*s.* 10*d.*

W. Smith's loan is secured by an assignment of a policy on A's life valued at £100.

There are contingent liabilities on bills discounted amounting to £598 17*s.* 2*d.*, of which the sum of £229 13*s.* 5*d.* is expected to rank.

Of the Book Debts, A states that £144 are bad and £365 doubtful; he estimates the value of the latter at £178.

Of the Bills Receivable, he estimates that the sum of £283 3*s*. 7*d*. is bad.

A has private debts, amounting to £389 5*s*. 3*d*., and has private assets consisting of the above-named policy and household furniture valued at £585.

SUMMARY OF ASSETS AND LIABILITIES.

Liabilities.	£	s.	d.	Assets.	£	s.	d.
Sundry Creditors .	23,598	7	6	Cash in hand . .	29	2	7
Bank Loan . .	6,897	3	6	Petty Cash in hand .	2	13	9
W. Smith, Loan .	589	2	6	Stock at cost . .	9,852	8	7
H. Jones, nine months' rent to September 29	150	0	0	Fixtures and Fittings .	329	7	2
Rates, six months' to March 31 . .	32	3	6	Office Furniture. .	262	8	0
				Horses and Carts. .	682	5	0
				Sundry Debtors .	5,289	3	5
				Bills Receivable. .	4,283	3	7
				Freehold Property .	6,589	2	7
	£31,266	17	0		£27,319	14	8

(*Chartered Accountants*.)

34. A trustee of a bankrupt estate, with liabilities of £18,000, has completed his realisation of the estate, and prepares to close the matter. His receipts have been: From Stock-in-Trade, £1,250; Book Debts, £3,100; Jewellery Pledged, £700; Trading, £7,000; Household Furniture, £450; Freehold Buildings, £3,000. His payments have been: Costs of Petition, £40; Auctioneer's Costs, £180; Shorthand Writers' Charges, £15; Trading Payments, £6,250; Mortgage on Freehold, £2,000; Board of Trade Fees, £80; Notices in *Gazette*, etc., £5; To redeem Jewellery, £400.

The Committee allow the remuneration of the trustee at a commission of 5% on assets realised and 3% on assets distributed. Without providing for further payments, you are required to write up the Estate Cash Book, showing the final close of the estate. You must assume that all items have been received from or paid to Bank, but analysis columns may be dispensed with. (*Incorporated Accountants*.)

35. A receiving order was made against A. Boot, on June 25. The following are the balances of his books at that date:—

	£	£
Unsecured Creditors		3,940
Capital Account, A. Boot		700
J. Smith, Loan Account		564
W. Jopp, Loan Account		12,654
Stock	4,113	
Fixtures and Fittings.	250	
H. Finlay (Rent one year)		350
H. Jones, Manager (£150 per annum) . . .		100
Collector, Rates and Taxes		85
Cash in hand and at Branches	110	
Horses, Carts, etc.	251	
Bill Receivable	169	
Sundry Debtors	2,446	
Cash at Bank	356	
Freehold and other Property	5,000	
Policy of Insurance (Surrender Value) . . .	1,778	
Profit and Loss	776	
Drawing Account, A. Boot	1,219	
Interest on Loans	1,925	
Contingent Liability on Bills Discounted, £355 not expected to rank		
	£18,393	£18,393

On January 1 previous, there was a surplus of assets of £700. J. Smith hold a first charge on the policy of insurance. W. Jopp holds a second charge thereon and also a charge on the Freehold and Leasehold Property. The Stock, for th purposes of the Statement, is valued at £3,500. Of the Book Debts, £291 ar doubtful, and are estimated to produce £100; £287 are bad. The loss on tradin between January 1 and June 25 was £776.

Make out the Statement of Affairs and the Deficiency Account in the form required under the Act. (*Chartered Accountants.*)

36. A trader files his petition in bankruptcy on June 30, 19..., and you ar instructed to prepare his Statement of Affairs. The information you are able t obtain as to his position is as follows:—

The Stock-in-trade at cost is £7,200, of which £600 worth is in the hands of creditor for £1,000, who is entitled to exercise a lien; Book Debts—Good, £9,750 Doubtful, £120 (worth 6*s.* 8*d.* in the £); Bad, £150; Fixtures and Fittings (afte depreciation), £230; Cash in hand, £10; Bills Receivable, £1,100 (held by Banker against overdraft of £4,000, the balance of which is secured by a second charge o debtor's freehold property and by the guarantee of his brother); Customers' bill under discount, £1,500, of which £200 is ascertained to be bad, and £100 i doubtful; Freehold Property, £3,000, subject to a first mortgage of £2,000. Th Unsecured Creditors amount to £29,000, in addition to claims for Rates, Taxe and Wages amounting to £240. The Stock-in-Trade and the Book Debts (outsid the bills) are estimated to be worth 75% of their face value, and the freehol property, which cost £2,800, is valued at £2,200. Subject to the modification above stated, the assets are worth their book values.

You learn that the debtor had a surplus of assets of £5,000 on January 1 19..., since when he has withdrawn £3,000 per annum in equal monthly instalments. His profits for year ended December 31, 19..., were £2,100, and for th next year, £420, since which time he has not made up his books.

From these details you are required to prepare as nearly as may be in statutor form: (*a*) A Statement of Affairs; (*b*) a Deficiency Account. (*Incorporate Accountants.*)

37. From the following figures prepare Statement of Affairs and Deficienc Account as at December 31. Assume that the Stock realises two-thirds of i value, the Fixtures one-half, the Shares par, and the Doubtful Debts one-thir On January 1, two years ago, the debtor commenced business with a capital £3,175. His profits for the first two years amounted to £2,027 10*s.* 6*d.*, and h drawings were £1,500 a year.

Cash, £115 10*s.* 6*d.*; Stock-in-trade, £500; Debtors—Good, £3,500; Doubtfu £900; Bad, £750; Fixtures and Fittings, £282; Shares, £250; Creditors, u secured (including £950 for wife), £6,950; Creditors, secured, £1,250; Value securities held by creditors, £1,750; Preferential Claims for Rent, Rates, an Taxes, £95. (*Incorporated Accountants.*)

CHAPTER XIX

ASSURANCE ACCOUNTS

THE term "Assurance" should be confined to the making of provision against events that are bound to happen, *e.g.* death; the term "Insurance" to provision against events that may or may not happen, *e.g.* loss by fire. Technically, the first term is confined to Life Assurance and the second to contracts of indemnity entered into against loss from "perils of the sea" (Marine), Fire, Personal Accident, etc.

Definition.—A contract of life assurance is not a contract of indemnity. It is a contract, evidenced by a document, termed the *Policy*, whereby the *assurer* (the assuring company), in consideration of the payment of a *premium* by the *assured* (the person assured), agrees to pay a specified sum (with a share of the Company's profits, if the policy be a participating one) on the occurrence of a stated event in the life of the assured. The event may be: (*a*) the reaching of a certain age, or (*b*) death; and the premium may be: (*a*) a sum down, termed a *single premium*, or (*b*) equivalent annual payments termed *annual premiums*, to be made during the life, or during a stated part of the life, of the assured. Annual premiums may by arrangement be paid half-yearly, quarterly, or even monthly, the company charging a slightly higher rate for the accommodation.

The policy is based upon a *Proposal Form*, issued by the company. This form contains a series of questions to be answered by the proposer. The utmost faith must be observed in answering these questions, and, n addition, the proposer is bound to disclose any material facts not rought out by the questions which the company ought to know in rder to be able precisely to estimate the risk. Wilful errors in statenents of fact, or the suppression of material facts, render a contract f life assurance liable to be declared void. Contracts of this kind are nown as contracts *uberrimæ fidei*, *i.e.* of the utmost faith.

Classes of Life Assurance.—Life Assurance is divided into two broad lasses, viz.: (*a*) *Ordinary*; (*b*) *Industrial*. In the first class, the premiums are paid either directly to the company or through the agent who fected the assurance on behalf of the assured, and the sum assured is rely less than £50. In the second class, the premiums are collected eekly or monthly from the assured by house-to-house visitation, and e sum assured may be as low as £1.

Kinds of Offices.—Life offices are divided into two classes: (*a*) *utual* offices; (*b*) *Proprietary*, or rather, *Mixed* offices. A mutual fice is one wherein the participating policy holders themselves form e proprietors, and the whole of the profit is divided amongst them. mixed office is a limited company, whose capital is subscribed in e ordinary [illegible] and the participating policy holders in a ratio varying from 80 to 95% to the participating policy holders and the remainder to the shareholders.

Those offices which have combined for the purpose of fixing agreed uniform rates for various kinds of risk are termed *Tariff Offices*. Offices outside this combination are known as *Non-Tariff Offices*. But this distinction applies mainly to Fire and Employers' Liability Insurance, and not at all to Life Assurance, which is competitive.

Kinds of Insurance.—Almost any kind of risk can be insured against in these days. In addition to Life Assurance, the chief kinds of insurance are: Marine, Fire, Personal Accident, Employer's Liability, and Bond Investment insurance. Other risks insured against are: Sickness, Third Party Indemnity, Motor Car and Cycle, Burglary, Plate Glass, Forged Transfers, Cash and Jewellery and other valuables in course of transit, Hail, Storm, Lightning, Civil Commotion, War, including damage by hostile aircraft, etc.

Basis of Life Assurance.—Life Assurance is based upon two main principles: (*a*) the Expectation of Life, more correctly termed the "Mean After-Lifetime"; (*b*) the rate of interest that will probably be earned on funds invested at compound interest. The term "Expectation of Life" does not, as is sometimes erroneously supposed, signify the number of years that persons of a given age may reasonably expect still to live, for many lives will fall short of this period, and many will long survive it. It has no relation to the most probable afterlifetime of any particular person, but is computed over a large number of lives by taking the excess years of those who live long and distributing them amongst those who die early, thus placing all lives of the same age on an equality. This function, the Mean After-Lifetime, is deduced from *Mortality Tables*.

A Mortality Table has been defined as "the instrument by means of which are measured the probabilities of life and the probabilities of death." There are two kinds of Mortality Tables: (*a*) those based upon Census Returns, and the deaths that have taken place during a definite period of time, and (*b*) those based upon the experience of assured lives, derived either from a single life office or from a combination of Life Offices. The latest tables are the British Offices' Experience Tables (indicated by the symbol O), which were based upon the experience of 1,037,233 assured lives, contributed by sixty British Life Offices.

The data derived from the sources mentioned above are subjected by skilled persons, known as *Actuaries*, to the process termed Graduation, by which the fluctuations in the ungraduated mortality statistics, due to error, or disturbing influences, *e.g.* an inadequate number of observations, are eliminated, and the general rate of mortality is brought out.

The premium consists of (*a*) the *pure premium*, *i.e.* the annual sum which if paid by a sufficient number of persons of the same age, and accumulated at compound interest, say 3½% per annum, will amount at death to their various sums assured, and (*b*) a *loading* to cover all the expenses of the office, and to provide a margin for a possible increase in the future rate of mortality, and for profits. The pure premium plus the loading make up the *office premium* charged by the company and paid by the assured.

Assuring companies limit the risk that they will assume on any one life by *re-assuring* with other companies that portion of the risk in excess of their maximum. The premiums paid for re-assurances are deducted from the item "Premiums Received" in the Revenue Account. A few companies confine their business to re-assurances.

Annuities.—Most assurance companies, in return for an immediate cash payment, undertake to pay an agreed sum yearly (half-yearly, or quarterly) during the lifetime of a specified person, termed the *Annuitant.* The purchase price is based on the age and sex of the Annuitant, less favourable rates being quoted in the case of female lives, owing to the greater longevity of women.

Insurable Interest.—In the great majority of cases, assurances are effected on the assured's own life. But one person may assure the life of another, provided that he has an *insurable interest, i.e.* a pecuniary interest, in the life of the other, only, however, to the extent that he has such an interest. Thus a creditor may, by way of collateral security, assure the life of his debtor to the extent of the debt; a wife may assure her husband's life in order to secure for herself a fixed sum should he pre-decease her; a partner may assure his co-partner's life in order to provide means to pay to the co-partner, or to his legal representatives, his share of the partnership assets on retirement or at death. By the provisions of the *Gambling Act,* 1774, a policy issued in the name of a person who has no insurable interest in the life assured may be declared void. Insurable interest is also necessary in the case of policies taken out to cover fire, marine, and other risks.

Lapsed Policies.—Thirty days' grace is allowed for the payment of assurance premiums, and failing payment within this extension the policy lapses and becomes void. But, whether the assured be alive or dead, the policy is capable of revival within twelve months, if five years' premiums have been paid, by payment of the outstanding premium plus a fine. If less than five years' premiums have been paid, the lapsed policy may be revived on the same conditions, but subject to evidence that the assured is in good health.

Surrender Value.—Where an assured desires to surrender his policy before he has completed his contract, the assurance company will pay to the assured a sum termed the *Surrender Value* of the policy. This Surrender Value is based upon the Reserve Value of the policy. The Reserve Value consists of that portion of the annual premiums not required to cover the risk for the year accumulated at compound interest. As a rule, a policy does not acquire a surrender value until three years' premiums have been paid (Endowment policies, two years), for the reason that the premiums paid during those early years are, for the greater part, absorbed by office expenses. Surrenders are usually made by the young and vigorous assured, and so exercise an injurious effect upon the assured as a whole by increasing the rate of mortality amongst the older and less vigorous who continue their policies for the full term of the contracts. The withdrawal of a number of first-class lives has precisely the same effect on the assured as a whole as would result from the addition of an equal number of inferior lives. For that reason, Life Offices, when computing the surrender value of a policy, make a sufficient deduction from the Reserve Value to counteract the effect of surrenders. Further, wherever that course can be followed, companies prefer to issue a paid-up policy based upon the Surrender Value, and so keep some part of the assurance in being; or they will apply the Surrender Value to the payment of future premiums, and keep the original policy in force until the Surrender Value is exhausted. The Surrender Value of a policy has no direct connection with the amount of the premiums paid, but, of course, it increases, and at an accelerated rate, with the payment of each premium. Most Life Offices guarantee on surrender a minimum proportion of the premiums paid, generally one-half for Endowment and one-third for Whole-Life Policies, with, in addition, any Reversionary Bonuses that may attach to the policy. The fact that policies acquire a surrender value gives them market value, and makes them available for loans.

Assignment.—A policy of life assurance may be assigned by one person to another either absolutely or by way of mortgage. In both cases formal notice of the Assignment should be given to the company, and upon request, and payment of a fee of 5*s*., the company must acknowledge receipt of such notice. Companies do not, however, insist upon receiving the fee before acknowledging the receipt of notice. Notice enables the assignee to sue the company in his own name without joining the assignor as party to the suit.

Where a company receives notice of more than one assignment of the same policy, *e.g.* successive equitable mortgages, the priorities as between the assignees are determined, so far as the company is concerned, in order of the dates on which notice was received. But this does not necessarily affect the priorities of the assignees as between themselves, since these may sometimes be determined upon other grounds. Thus, where a person advances money on a policy, and he has had previous notice, actual or constructive, of a prior charge thereon, he cannot by giving notice thereby secure priority over the first incumbrancer, if the latter has omitted to give notice.

Absolute assignments made for "valuable consideration" should be signed in the presence of a witness and be impressed with duty at the scheduled rate. An Ante-nuptial Settlement made for the benefit of a wife and children of the marriage, which may include a policy of life assurance, is made for valuable consideration.

Where the absolute assignment is voluntary, that is, not made for valuable consideration, but for "love and affection," as, *e.g.* in a Post-nuptial Settlement, the instrument must be stamped as if made for valuable consideration. But it is void as against the Trustee in Bankruptcy should the assignor become bankrupt within two years of making it, and it is void against the Trustee within ten years of making it, unless the parties claiming under the settlement can prove that the assignor was at the time of the assignment able to pay all his debts without the aid of the sum represented by the value of the policy, and that then his interest in the policy passed absolutely to the assignee (*Bankruptcy Act*, 1914, S. 42).

Assignments by way of mortgage which may be either legal or equitable, are subject to the mortgagor's "equity of redemption." Only when the mortgagor has lost that right can the mortgagee exercise his power of sale, or surrender the policy to the company. But the mortgagee must account to the mortgagor for any surplus realised by sale or surrender, so long as the mortgagor has not lost his equity of redemption.

A legal mortgage is effected by deed and deposit of the policy. The deed must be stamped according to schedule.

Equitable mortgage of a policy is effected by deposit of the policy accompanied by a Memorandum of Charge, which is stamped at the rate of 1*s*. per cent. on the amount of the loan.

A person who takes assignment of a policy as security for a loan should insist upon deposit of the policy, since the fact that the policy was in the hands of a third party might affect him with notice of a prior incumbrancer to whom he would be postponed.

Claims.—The amount assured may become payable either by maturity of the policy or by death. A claim by maturity (Endowment Assurance), if made by the assured himself, is promptly paid on production of satisfactory evidence as to his age, identity, and title. Similar promptitude is observed if the assurance has been effected by a third person, *e.g.* a wife, provided she is alive at the date of maturity. Where the claim arises by reason of death, greater formality is observed. The company will then require a Registrar's Certificate of Death; a Declaration, made by some competent and disinterested person, as to the identity of the person described in the certificate with the life assured under the claimed policy; evidence of the date of birth; and the production either of Probate of his will or Letters of Administration of his estate. It is always advisable to get the date of birth admitted on taking out the policy by producing a copy of the Birth Certificate, or failing that, other evidence of birth which the company will accept, *e.g.* a Certificate of Baptism, an extract from an entry in a family Bible, or other family register.

Bonuses.—There are many kinds of policies issued by Life Offices. The most popular are *Endowment Policies*. Next in order are *Whole Life Policies*, the premium being paid: (*a*) by a single sum down, or (*b*) by yearly premiums of equal amount, or (*c*) a limited number of premiums of larger amount, or (*d*) lower annual premiums during the first five years and higher annual premiums thereafter. Other policies issued are: Policies upon Joint Lives; Survivorship Policies; Short Period Policies; Children's Deferred Assurances; Sinking Fund Assurances, etc.

The broad line of demarcation between policies is that *with profits* and that *without profits*. The amount payable, when the claim arises.

on a policy without profits is the amount of the sum assured; the amount payable on a policy with profits is the sum assured plus a share of the surplus of the company's assets over its liabilities as determined by each Quinquennial (or Annual) Valuation made by the company, and declared by the company as a *bonus* to its participating policy holders.

The sources of a surplus are mainly three: (*a*) where the loading added to the premium to cover expenses has proved to be greater than was necessary to defray them; (*b*) where the rate of mortality, owing to careful selection of risks, has proved lighter than that indicated by the Tables; (*c*) where a good interest return has been earned, owing to careful movement by the company of its funds, combined with a low rate of interest adopted for valuation.

There is more than one method of distributing a surplus amongst the participating policy-holders, and more than one method of applying the bonus when declared. As to their application, bonuses may be taken in cash; or be added to the sum assured; or be applied to reduce future premiums, or to convert a Whole Term Policy into an Endowment Assurance payable at an advanced age, or, if the policy be an Endowment policy, to making it payable at a younger age.

Profits of Assurance Companies.—The profits of assurance companies cannot be ascertained by ordinary accounting methods; they must be determined by actuarial valuation. The *Assurance Companies Act*, 1909 (S. 5), regulates the frequency of actuarial valuations, which must take place "once in every five years, or at such shorter intervals as may be prescribed by the instrument constituting the company, or by its regulations or bye-laws." The majority of companies make a valuation once in every five years. This is known as the *Quinquennial Valuation*. But not a few companies make a yearly valuation, and some companies which distribute their bonuses quinquennially are in the habit, for their own private information, of valuing their assets and liabilities at the end of every year.

The objects of a valuation are: (*a*) to ascertain the company's net liability in respect of all its policies and annuity contracts; (*b*) to determine the value of the amount of its Life and Annuity funds.

The method of valuation is to find: (*a*) the present value of the sum of all the assurances and annuities to be paid by the company as they fall due, and (*b*) the present value of all the pure premiums to be paid by the assured as they fall due. The difference between these two is the Reserve, or sum of money that must be set aside, which, with the future pure premiums to be paid by the assured and accumulated at the rate of interest adopted for the valuation, will enable the company to pay all the claims as they arise.

Provision is made for future expenses and profits by valuing only the pure premium, *i.e.* by excluding that part of the office premium termed the loading.

The valuation of the liabilities is not made on the same basis as that adopted for the formation of the premium charged to the assured, but according to the most stringent mortality table and at the lowest rate of interest that will permit the payment of a fair rate of bonus to the assured. These premiums are termed *Valuation Premiums*, and their employment brings out a larger necessary Reserve than would be the case if the pure premium charged to the assured were employed. It is imperative that a Life Company's Reserve should be adequate to meet its liabilities and to provide for contingencies, hence the stringency of the valuation.

Against the Reserve required to discharge all its liabilities as they fall due, a company has its Life and Annuity Funds, being past premiums paid, accumulated at compound interest, less claims, management expenses, and profits paid prior to the valuation. These funds are invested in various ways: Mortgages; British Government Securities; Loans on Policies and other Reversionary Interests; Loans on Personal Security; Debentures; Stock Exchange Securities, etc. They must all be valued in the light of the facts and conditions prevailing at the time of valuation.

The difference between the amount required to be reserved by a company, and the amount of its Funds in Hand, as ascertained by valuation, represents its surplus or deficiency, as the case may be. If the surplus is large enough, a bonus is declared on the participating policies, and (if the company be a mixed one) a dividend to the shareholders. If the surplus is insufficient, both bonus and dividend may be passed, the amount being utilised to strengthen the company's Reserve. If an actual deficiency is disclosed, steps must be taken immediately to restore the financial position of the company.

Reference to the *Valuation Balance Sheet* on p. 741 will show that the company's total liability, *i.e.* the Reserve necessary to meet that liability, as disclosed by valuation, appears on the debit side of the statement, against which, on the credit side, appears the total of the Life and Annuity Funds, as set out in detail in the Third Schedule, and also ascertained by valuation. The balance, if a surplus, is available for the appropriation of dividends to shareholders, bonuses to participating policy holders, transfers to Reserve, and the like.

Neither the accountants nor the auditors of a Life Company have any concern with the Quinquennial or other Valuation. That is solely actuarial work.

Assurance Accounts.—Assurance Companies are governed by the *Assurance Companies Act*, 1909, and are also subject to the *Companies Act*, 1948, so far as that Act applies. The schedules appended to the Act of 1909 display the forms of account obligatory upon insurance companies.

The Act embraces all persons, companies, or corporations transacting: (*a*) Life, (*b*) Fire, (*c*) Accident, (*d*) Employers' Liability Insurance, and (*e*) Bond Investment Business.

Deposit.—Every company transacting life assurance must deposit with the Paymaster-General of the Supreme Court a permanent deposit of £20,000, and all companies registered after July 1, 1910, must deposit a further sum of £20,000 for each of the other kinds of insurance business conducted by them—(*a*) to (*e*) above. These regulations are modified by SS. 31 and 32 of the Act of 1909, as follows: (1) Neither deposits nor separate funds are necessary in the case of Fire and Accident business if the company has made a deposit in respect of any other class of insurance. (2) In the case of Employers' Liability and Bond Investment business, when the separate funds have reached £40,000, the original deposit of £20,000 is refunded if deposits have been made in respect of any other class of business. Companies transacting Re-insurance business exclusively have been held liable to make the usual deposit.

Accounts.—Separate Revenue Accounts must be presented and separate funds be kept for each class of business transacted. Each separate fund is to be the security of the policy-holders of that class and is not to be applied except for their service. The Auditors must certify that this regulation has been complied with.

At the end of each financial year, the company must prepare: (*a*) Revenue Account (First Schedule) for each particular class of business (*b*) Profit and Loss Account (Second Schedule), except where the company carries on one class of business only; (*c*) Balance Sheet (Third Schedule). These accounts must be printed, and four copies must be deposited with the Board of Trade within six months of the close of the period to which they relate. These accounts are subjec to audit under the provisions of the *Companies Act*, 1948, and shareholders and policy-holders are entitled to copies of them. The Fourth Schedule consists of the Valuation Balance Sheet dealt with above The prescribed forms for the above accounts are shown on pp. 737–741

It will be noted that the Statutory form of Balance Sheet enforce publication of full details of the assets held. The power of an assuranc company to meet its obligations is of paramount concern to the assured Hence the object of the legislature is to ensure that full material fo judgment shall be available.

The Revenue Account is a simple Income and Expenditure Accoun (with the sides reversed), the object of which is to show the growth o decline of the Funds in Hand available to meet the Company's liabilities. The Profit and Loss Account is necessary only where more tha one class of business is transacted. It then takes the place of th Appropriation Account of commercial usage, combining the profits o the several departments, and showing the dividends and bonuses paid If the Company is a limited company, the Balance Sheet (Schedule E may be filed with the Registrar as "the statement in the form of Balance Sheet."

The Accounts of British Assurance Companies are published annuall by the Board of Trade and form a bulky Blue Book.

The student who desires to follow Assurance matters in mo detail than is possible in this place is referred to the author's *Accountin* pp. 792–837.

SCHEDULES.

FIRST SCHEDULE.

N.B.—Where marine insurance business or sinking fund or capital redemption insurance business is carried on, the income and expenditure thereof to be stated in like manner in separate accounts. Any additional businesses (including employers' liability insurance business transacted out of the United Kingdom) to be shown in a separate inclusive General Account.

A.—Form Applicable to Life Assurance Business.

Revenue Account of the .... for the Year ending .... in respect of Life Assurance Business.

	Business within the United Kingdom.	Business out of the United Kingdom.	Total.		Business within the United Kingdom.	Business out of the United Kingdom.	Total.
	£ s. d.	£ s. d.	£ s. d.		£ s. d.	£ s. d.	£ s. d.
Amount of life assurance fund at the beginning of the year . .				Claims under policies paid and outstanding :—			
Premiums :—				By death			
Consideration for annuities granted .				By maturity			
Interest, dividends, and rents . . . £ d.				Surrenders, including surrenders of bonus			
Less income tax thereon				Annuities			
Other receipts (accounts to be specified)				Bonuses in cash			
				Bonuses in reduction of premiums .			
				Commission			
				Expenses of management			
				Other payments (accounts to be specified)			
				Amount of life assurance fund at the end of the year, as per Third Schedule			
	£				£		

Note 1.—Companies having separate accounts for annuities to return the particulars of their annuity business in a separate statement.

Note 2.—Companies having both Ordinary and Industrial branches to return the particulars of the business in each department separately.

Note 3.—Items in this account to be net amounts after deduction of the amounts paid and received in respect of re-assurances of the Company's risks.

Note 4.—If any sum has been deducted from the expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted
o be separately shown in the above Account.

Note 5.—Particulars of the new life assurances effected during the year of account to be appended to the above account showing separately, as respects business within
nd business out of the United Kingdom, the number of policies, the total sums assured, the amount received by way of single premiums, and the amount of the
early renewal premium income, the items to be net amounts after deduction of the amounts paid and received in respect of re-assurances of the company's risks.
he particulars as to yearly renewal premium income need not be furnished in respect of Industrial business.

Note 6.—The columns headed "Business out of the United Kingdom," in the case of companies having their head office in the United Kingdom, apply only to
siness secured through Branch Offices or Agencies out of the United Kingdom.

B. FORM APPLICABLE TO FIRE INSURANCE BUSINESS.

Revenue Account of the .... for the Year ending .... 19... in respect of Fire Insurance Business.

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Amount of fire insurance fund at the beginning of the year:							Claims under policies, paid and outstanding						
Reserve for unexpired risks							Commission						
Additional reserve (if any)							Expenses of management						
							Contributions to fire brigades						
Premiums							Other payments (accounts to be specified)						
Interest, dividends, and rents	£	s.	d.				Amount of fire insurance fund at the end of the year as per Third Schedule:	£	s.	d.			
Less income tax thereon							Reserve for unexpired risks, being ... per cent. of premium income for the year						
Other receipts (accounts to be specified)							Additional reserve (if any)						
				£							£		

Note 1. Items in this account to be the net amounts after deduction of the amounts paid and received in respect of re-insurances of the Company's risks.
Note 2. If any sum has been deducted from the Expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted is to be separately shown in the above account.

C. FORM APPLICABLE TO ACCIDENT INSURANCE BUSINESS.

Revenue Account of the .... for the Year ending .... 19... in respect of Accident Insurance Business.

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Amount of accident insurance fund at the beginning of the year:							Payments under policies, including medical and legal expenses in connection therewith						
Reserve for unexpired risks							Commission						
Total estimated liability in respect of outstanding claims							Expenses of management						
Additional reserve (if any)							Other payments (accounts to be specified)						
Premiums							Amount of accident insurance fund at the end of the year as per Third Schedule:	£	s.	d.			
Interest, dividends, and rents	£	s.	d.				Reserve for unexpired risks being ...... per cent. of premium income for the year						
Less income tax thereon							Total estimated liability in respect of outstanding claims as per Fourth Schedule (C)						
Other receipts (accounts to be specified)							Additional reserve (if any)						
				£							£		

[illegible] received in respect of re-insurances of the Company's risks.

D. FORM APPLICABLE TO EMPLOYERS' LIABILITY INSURANCE BUSINESS.

Revenue Account of the .... for the Year ending .... 19... in respect of Employers' Liability Insurance Business transacted within the United Kingdom.

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Amount of employers' liability insurance fund at the beginning of the year:—							Payments under policies, including medical and legal expenses in connection therewith						
Reserve for unexpired risks							Commission						
Total estimated liability in respect of outstanding claims							Expenses of management						
Additional reserve (if any)							Other payments (accounts to be specified)						
Premiums							Amount of employers' liability insurance fund the end of the year, as per Third Schedule:						
Interest, dividends, and rents							Reserved for unexpired risks, being ...... per cent. of premium income for the year						
Less income tax thereon							Total estimated liability in respect of outstanding claims, as per Fourth Schedule (D)						
Other receipts (accounts to be specified)							Additional reserve (if any)						
				£							£		

Note 1. Items in this account to be the net amounts after deduction of the amounts paid and received in respect of re-insurances of the Companys' risks.
Note 2. If any sum has been deducted from the Expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted to be separately shown in the above account.

E. FORM APPLICABLE TO BOND INVESTMENT BUSINESS.

Revenue Account of the .... for the Year ending .... 19... in respect of Bond Investment and Endowment Certificate Business.

	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.
Amount of Bond Investment and Endowment Certificate Fund at the beginning of the year							Claims under bonds and certificates, paid and outstanding						
Additional reserve (if any)							Commission						
Premiums							Expenses of management						
Interest, dividends, and rents							Other payments (accounts to be specified)						
Less income tax thereon							Amount of Bond Investment and Endowment Certificate Fund at the end of the year as per Third Schedule						
Other receipts (accounts to be specified)							Additional reserve (if any)						
				£							£		

Note 1. Items in this account to be the net amounts after deduction of the amounts paid and received in respect of re-insurances of the Company's risks.
Note 2. If any sum has been deducted from the Expenses of Management Account, and taken credit for in the Balance Sheet as an asset, the sum so deducted o be separately shown in the above account.

SECOND SCHEDULE.

PROFIT AND LOSS ACCOUNT OF THE .... FOR THE YEAR ENDING .... 19...

	£	s.	d.	£	s.	d.		£	s.	d.
lance of last year's account							Dividends and bonuses to shareholders			
crest and dividends not carried to other accounts.							Expenses not charged to other accounts			
Less income tax thereon							Loss realised (accounts to be specified)			
ofit realised (accounts to be specified)							Other payments (accounts to be specified)			
her receipts (accounts to be specified)							Balance as per Third Schedule			
				£				£		

THIRD SCHEDULE.

BALANCE SHEET OF THE .... ON THE .... 19...

LIABILITIES.	£	s.	d.	£	s.	d.	ASSETS.	£	s.	d.
hareholders' Capital paid up (if any)							Mortgages on Property within the United Kingdom			
ife Assurance Funds * :—							Mortgages on Property out of the United Kingdom			
Ordinary Branch							Loans on Parochial and other Public Rates			
Industrial Branch							Loans on Life Interests			
nnuity Fund *							Loans on Reversions			
ire Insurance Fund							Loans on Stocks and Shares			
ccident Insurance Fund							Loans on Company's Policies within their Surrender Values			
mployers' Liability Insurance Fund							Loans on Personal Security			
ond Investment and Endowment Certificate Fund							Investments: Deposit with the High Court (Securities to be specified)			
arine Insurance Fund							British Government Securities			
inking Fund and Capital Redemption Fund							Municipal and County Securities, United Kingdom			
rofit and Loss Account							Indian and Colonial Government Securities			
ther Funds (if any) to be specified							Indian and Colonial Provincial Securities			
							Indian and Colonial Municipal Securities			
laims admitted or intimated but not paid † :—	£	s.	d.				Foreign Government Securities			
Life Assurance							Foreign Provincial Securities			
Fire Insurance							Foreign Municipal Securities			
Bond Investment							Railway and other Debentures and Debenture Stocks—Home and Foreign			

Annuities due and unpaid †			Railway and other Preference and Guaranteed Stocks		
Other sums owing by the company † (to be stated separately under each class of business).			Railway Ordinary Stocks		
			Rent Charges		
			Freehold Ground Rents		
			Leasehold Ground Rents		
			House Property		
			Life Interests		
			Reversions		
			Agents' Balances		
			Outstanding Premiums †		
			Outstanding Interest, Dividends, and Rents †		
			Interest accrued but not payable †		
			Bills Receivable		
			Cash: On Deposit		
			In hand and on Current Account		
			Other Assets (to be specified)		
	£			£	

Note 1.—When part of the assets of the company are specifically deposited, under local laws, in various places out of the United Kingdom, as security to holders of policies there issued, each such place and the amount compulsorily lodged therein must be specified in respect of each class of business, except that, in the case of fire, accident, or employers' liability insurance business, it shall be sufficient to state the fact that a part of the assets has been so deposited.

Note 2.—A Balance Sheet in the above form must be rendered in respect of each separate fund for which separate investments are made.

Note 3.—The Balance Sheet must state how the values of the Stock Exchange securities are arrived at, and a certificate must be appended, signed by the same persons as sign the Balance Sheet, to the effect that in their belief the assets set forth in the Balance Sheet are in the aggregate fully of the value stated therein, less any investment reserve fund taken into account. In the case of a company transacting life assurance business or bond investment business, this certificate is to be given on the occasions only when a statement respecting valuation under the Fourth Schedule is made.

Note 4.—In the case of a company required to keep separate funds under section 3 of this Act, a certificate must be appended, signed by the same persons as signed the Balance Sheet and by the auditor, to the effect that no part of any such fund has been applied, directly or indirectly, for any purpose other than the class of business to which it is applicable.

* Life companies having separate annuity fund to show amount thereof separately.

† These items are or have been included in the corresponding items in the First Schedule.

FOURTH SCHEDULE.

VALUATION BALANCE SHEET OF .... AS AT .... 19...

Dr.	£	s.	d.	Cr.	£	s.	d.
To Net Liability under Life Assurance and Annuity Transactions (as per summary statement provided in Fourth Schedule (A))				By Life Assurance and Annuity Funds (as per Balance Sheet under Schedule 3)			
,, Surplus, if any				,, Deficiency, if any			
	£				£		

EXAMINATION QUESTIONS.

1. What statute now regulates the accounts of Assurance Companies? Briefly describe the accounts which a Life Assurance Company is under obligation to publish. (*Royal Society Arts.*)

2. In connection with Insurance, what do you understand by the following: Mutual Companies; Tariff Companies; Surrender Value; Quinquennium? (*Chartered Accountants.*)

3. Explain the following class of policies in connection with Assurance: Endowment; Whole Life; Without Profits.

4. What is meant by a "Quinquennial Valuation" in connection with life-assurance accounts? Submit a *pro-forma* Valuation Balance Sheet showing the results of a quinquennial valuation. (*Royal Society Arts.*)

5. Give a *pro-forma* Valuation Balance Sheet of an Assurance Company.

Contrast the methods of ascertaining profits employed by an Assurance Company with those of a commercial undertaking. (*London Chamber Commerce.*)

6. Under what heads should investments, other than Mortgages, of a Life Insurance Company be classified in the Balance Sheet so as to comply with the provisions of the *Life Assurance Companies Acts*? (*Chartered Accountants.*)

7. The following item appeared in the Balance Sheet of an Assurance Company: Loans on the Company's Policies within their Surrender Value, £45,986. Explain the meaning of this item, and describe the steps you would take to verify it as auditor to the Company. (*Chartered Accountants.*)

8. Briefly describe the form and scope of the annual accounts rendered obligatory on Assurance Companies by the *Assurance Companies Act*, 1909.

Select *one only* of these accounts, and contrast it with an account of like nature prepared for similar purposes by a commercial company. (*Royal Society Arts.*)

9. Explain the meaning of the undermentioned items which appeared in the annual accounts of a Life Assurance Company, and state where they should appear in the published accounts of the Company: Life Assurance Fund at the beginning of the year, £4,099,971; Income Tax (less rebate) paid on interest, dividends, etc., £8,058; Claims, £198,487; Consideration for Annuities granted, £36,452; Deposit with the High Court, £20,440; Mortgages on Property within the United Kingdom, £409,489; Claims admitted but not paid, £66,431. (*Chartered Accountants.*)

10. Show the following amounts in the form prescribed in the First Schedule to the *Assurance Companies Act*, 1909:—

Amount of Fund at beginning of year, £1,410,000; Annuities payable, £14,800; Bonuses in cash, £2,700; Transfer and other fees, £150; Profit on Reversions, £5,010; Transfer from General Fund, £2,600; Interest and Dividends, £63,030; Claims, £51,500; Claims by Maturity, £28,100; Consideration for Annuities Granted, £10,000; New Premiums, £19,000; Renewal Premiums, £118,000; Surrenders, £8,700; Commission, £6,100; Expenses of Management, £15,010.

11. Prepare Revenue Account and Balance Sheet, as on December 31, 1933, of the Popular Mutual Assurance Company, the following being the Ledger Balances: Assurance Fund, December 31, 1932, £739,100; Assignment Fees, £50; Annuities, £2,500; Agents' and other Debit Balances, £2,750; British Government Securities, £119,600; Consideration for Annuities granted, £6,200; Claims paid and outstanding, £51,800; Commission, £1,600; Claims admitted but not paid, £8,500; Cash at Bankers, £9,355; Cash in hand, £75; Deposit with the High Court, £20,000; Expenses of Management, £4,700; Foreign Government Securities, £33,800; Freehold Ground Rents, £46,900; House Property, £84,500; Interest, Dividends, and Rents, £29,400; Income Tax on Dividends and Rents, £1,650; Indian and Colonial Government Securities, £14,700; Interest accrued but not yet payable to the Company, £6,500; Loans on Reversions, £5,200; Loans on Policies, £53,100; Mortgages in the United Kingdom, £211,800; Outstanding Premiums, £8,420; Outstanding Interest, Dividends, and Rents, £700; Office Fixtures and Furniture, £1,200; Premiums, £52,600; Railway and other Debenture and Debenture Stocks, £137,200; Railway and other Preference Stocks

and Shares, £12,000; Surrenders, £3,400; Sundry Creditors, £2,[illegible]. (Chartered Accountants.)

12. Make out in the form prescribed the accounts of the Samaritan Assurance Society from the following: Assurance Fund, January 1, £2[illegible],642; Assurance Fund, December 31, £258,069; Premiums, £18,165; Outstanding Premiums £2,335; Loans on Society's Policies, £14,767; Consideration for Annuities granted, £850; Claims by death, £19,698; Commissions, £544; Expenses of Management, £2,344; Reductions allowed to members on their Premiums, £1,860; Interest, Dividends and Rents, £9,050; Annuities, £1,173; Mortgages on Property, £70,369; British Government Securities, £57,934; Railway Shares £112,746; Profit on Reversions fallen in, £2,156; Outstanding Interests and Rents, £1,081; Balances due by Agents, £66; Claims admitted but not paid £4,177; Depreciation on Investments, £3,975; Surrenders, £1,700; Sundry Creditors, £836; Loans on Personal Security, £987; Accrued Interest, £2,269 Cash in hand, £2,058. (Chartered Accountants.)

13. Prepare a Revenue Account and Balance Sheet from the following list of balances in the books of a Life Assurance Company:—

Assurance Fund at the beginning of the year, £3,600,000; Annuities Paid £12,500; Bonuses to Policy Holders, £15,000; British Government Securities £190,000; Consideration for Annuities granted, £14,000; Claims Admitted but not paid, £14,500; Claims Paid, £280,000; Commission Paid, £27,000; Cash at Bank, £45,000; Expenses of Management, £37,000; Indian and Colonial Government Securities, £110,000; Interest and Rents received, £130,000; Loans on Company's Policies, £280,000; Leasehold Ground Rents (Investments) £6,000; Mortgages within the United Kingdom, £800,000; Mortgages on Rates £1,200,000; Other Sums owing by the Company, £1,200; Outstanding Premiums and Agents' Balances, £56,000; Outstanding Interest (receivable), £57,000 Premiums, £460,000; Premises and Furniture, £26,000; Reserve Fund, £150,000 Rent Charges (Investments), £36,200; Railway and other Debentures, £1,150,000 Surrenders, £42,000. (Chartered Accountants.)

14. From the following Trial Balance prepare Balance Sheet and Revenue Account of the Life Assurance Society:—

Mortgages on Property within the United Kingdom, £400,000; Mortgages on Property out of the United Kingdom, £50,000; Loans on Life Interests, £100,000 Loans on Reversions, £200,000; Loans on Society's Policies within their Surrender Values, £600,000; Investments: Municipal Securities, United Kingdom, £500,000 Indian and Colonial Government Securities, £1,000,000; Freehold Ground Rents £800,000; Reversions, £500,000; Outstanding Premiums, £50,000; Outstanding Interest, Dividends, and Rent, £10,000; Surrenders on Business within the United Kingdom, £20,000; Surrenders on Business outside the United Kingdom £1,000; Cash in hand, £50,000; Claims admitted, but not paid (Cr.), £10,000 Claims on Business within the United Kingdom, £200,000; Claims on Business outside the United Kingdom, £10,000; Sundry Creditors, £15,000; Amount of Life Insurance Fund at beginning of year, £4,000,000; Expenses of Management £20,000; Premiums on Business within the United Kingdom, £480,000; Premiums on Business outside the United Kingdom, £6,000.

Note.—£10,000 Indian and Colonial Government Securities have been deposited with the Government of the Cape of Good Hope in respect of Life Assurance business. (*Incorporated Accountants.*)

CHAPTER XX

BANK BOOK-KEEPING

This chapter deals with the book-keeping system adopted by banks. No details can be given here of the various labour-saving machines now popular in banking circles.* Principles only can be dealt with.]

THE business of a banker is practically a cash business, and although it is not very complex, and subject to strict routine, yet the voluminous transactions, and the necessity for keeping the posting of the books abreast of the transactions, so that the bank may know how it stands as regards each customer individually, and its own position at the close of every day's business, make it imperative to employ special methods of posting. Unless the books are written up minute by minute, over-drawn accounts, with consequent bad debts, cannot be avoided. To meet this necessity for prompt entry of all transactions, banks have adopted the slip-system of posting. As the student is aware, this is not a system of book-keeping, but a method of rapidly posting books kept on double-entry principles. It is more fully employed by banks than by any other class of undertaking.

The current accounts of customers are kept posted continuously by means of slips, *i.e.* forms filled up either by the customers themselves, or by the bank officials. By far the greater proportion of payments into banks consist of cheques and (to a lesser extent), bills: only a relatively small proportion consists of notes and coin.

When cheques and cash articles are paid in to credit by customers, they are, as everybody knows, detailed in paying-in slips, the form of which needs no illustration here. The receiving cashier enters this paying-in slip in his Cash Book, and, having done so, passes it on to the Waste Book keeper for analysis. The keeper of the Waste Book hands it to the Ledger keeper to be posted, and from him it passes to those responsible for writing up the Pass Books. In a similar way, the original cheques drawn on the bank by its customers are utilised as posting slips, and these furnish material for the debits in the current Account Ledgers and the Pass Books.

It will easily be seen from the above that the double-entry is effected with the minimum delay. The cashier paying a customer's cheque over the counter, enters the amount in his Cash Book. At the end of the day, all these payments are aggregated and posted through the General Cash Book to the credit of the Cash Account in the General Ledger. This disposes of the credit entry. The cheques are handed, as they are paid, to the clerks who keep the current Account Ledgers, and are posted by them to the debit of the customers' current accounts, thus completing the double-entry. Subsequently the cheques are entered to the customers' debit in the Pass Books.

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* A text-book on the use of accounting machines that can be recommended confidently is *Machine Accounting* by Owen Sutton, issued by the publishers of this book.

By utilising slips in this way, numerous ledger keepers can post the ledgers almost as quickly as the transactions occur. This would be impossible if the usual bound books of original entry were employed.

Transactions that are not covered by original documents are posted by means of dockets, *i.e.* by forms filled up by the bank's own staff. Such transactions may concern bills discounted, coupons collected, cheque books supplied, loans advanced, interest charged or allowed, etc. Two specimen dockets appear below:—

NATIONAL PROVINCIAL BANK LIMITED

PRINCES STREET, E.C.
June 28, 19..

DEBIT *George Dickson*, Current Account for transfer to Deposit Account

£100 : 0 : 0

L. C. C.
Accountant

This docket results from instructions received by the bank from George Dickson to transfer £100 from his Current Account to Deposit Account.

June 30th, 19..

Debit *John Smith*
£1 : 4 : 9

For *Interest on Loan* *£100* to *date*

LLOYDS BANK LIMITED.

L. C. C.

This docket is made out by the bank staff in order to debit John Smith with interest on his loan to date.

It will be appreciated that the paying-in slips, paid cheques, and dockets are in effect loose journal entries from which the books are posted. A large proportion of a banks' staff is continuously employed in posting into current account ledgers and other books these loose journal entries. All the records made are interdependent and interlocking, and, in many cases, are arranged to pass through more than one pair of hands, as a safeguard against fraud.

A BANK'S BOOKS.

The items which compose a typical bank Balance Sheet indicate the Accounting requirements of a bank, and the financial and other books that must be provided to meet those requirements.

Pass Books.—These are issued to all customers who keep current accounts with a bank, and also to customers who keep deposit accounts. They serve to record all transactions between a bank and its customers, and to show the state of the account as between banker and customer. The pass book is the property of the customer, but all the entries in it must be made by the bank.*

The precise legal effect of entries in a pass book has never been exactly determined. Entries in favour of a customer are *prima-facie* evidence, but not conclusive evidence, against the banker. A banker may prove that an entry to a customer's credit is erroneous, and, if it is erroneous, the quicker he does so the better. But he cannot recover the amount wrongly credited, if the customer is able to show that in good faith and relying upon the accuracy of his pass book he was induced to alter his position, *i.e.* to spend money that otherwise he would not have spent. A business-man would not, as a rule, find it easy to establish his good faith in taking advantage of a wrong entry to credit. But it would be otherwise with, *e.g.* an army officer on active service whose account was replenished by payments in made on his behalf by an army agent (*Skyring* v. *Greenwood*, [1825]; *Holt* v. *Markham*, [1923]).

As regards entries against the customer, little more can be said than that, before a customer can be estopped from denying their accuracy, he must have been guilty of such negligence as to have caused the banker to alter his position detrimentally, or to have acted in such a way as to lead to the inference that he had treated the record in the pass book as a settled account. It is impossible to say, in the absence of any legal decision on the points, what conduct would constitute such negligence, or amount to an acknowledgment that the account was settled.

Prudence and sound business suggest that the banker should make up and send out the pass book at frequent and regular intervals, and the customer should carefully check the book, and immediately point out any inaccuracies, and this is the course followed.

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* The introduction of mechanical book-keeping has now resulted in the "Pass-Book" being a loose-leaf binder for which the bank provides loose sheets recording the copies of the entries made in the customer's Account.

Pass books show a certain amount of variation in form. A typical ruling is the following:—

A. K. Fison, Esq.

IN ACCOUNT WITH
WESTMINSTER BANK, LIMITED,
....................BRANCH.

Date.		Particulars.	Debits.			Credits.			Balance.			
			£	s.	d.	£	s.	d.	£	s.	d.	
Jan.	10	Balance . .							205	14	6	Cr.
,,	15	Barclays Bank .				25	0	0	230	14	6	Cr
,,	18	J. Brown . .	5	8	9							
,,	18	Cash . . .	10	0	0				214	15	9	Cr.
,,	20	L. C. Cropper . .	250	0	0				35	4	3	Dr.

It will be seen that the balance is shown at the end of each day on which any transaction has taken place. Some branches draw attention to an overdrawn (Dr.) balance by printing it in red: other branches use other methods, such as printing it in italics. It is the usual practice for auditors to apply *direct to the bank* for a certificate of the bank balance at the closing date of the accounts under audit. In most cases a Reconciliation Statement will be necessary in order to agree the amount certified with the Cash Book balance at the closing date.

The General Ledger.—This is the key ledger of a bank's accounting system. It contains adjustment accounts recording, in totals, the bank's assets, liabilities, profits, and losses, and their daily fluctuations. The ledger is self-balancing, and a Trial Balance extracted from it enables a Profit and Loss Account to be prepared expeditiously. Behind, and in support of, this ledger, there are numerous subsidiary ledgers and registers containing the detail of which the totals appearing in the General Ledger are composed. These ledgers "agree" with and explain their relative ledger accounts in the General Ledger. Totals only are entered in the General Ledger, and these represent the mass of detail arising out of the day's work, under each heading. Thus, for example, all cash paid in by customers during the day, appears in one total in Current Accounts of Customers' Account. At the close of each day, the detail balances of any single subsidiary ledger, or group of subsidiary ledgers, should agree with the relative account in the General Ledger. A list of accounts usually found in a bank's General Ledger, and a specimen account appears on p. 748.

On p. 749 is a specimen Trial Balance extracted from the General Ledger of a Bank. It is suggested that the student prepare from it a Profit and Loss Account and Balance Sheet in the form adopted by Banks.

Answer: Credit balance of P. and L. Account, £256,788 14s. 3*d.*; Balance Sheet totals, £21,142,612 11s. 5*d.*

GENERAL LEDGER ACCOUNTS.

LIABILITIES.		ASSETS.	
General Ledger Account.	Subsidiary Register or Ledger.	General Ledger Account.	Subsidiary Register or Ledger.
Share Capital.	Share Registers.	Cash.	Cashiers' Money Books.
Reserve.		Bank of England.	Bank of England Books.
Current Accounts.	Current Account Ledgers.	Banking Correspondents.	Correspondents Ledger.
Deposit Accounts.	Deposit Account Ledgers.	Short Loans.	Short Loans Ledgers.
Bills Payable (or Acceptances for Customers).	Acceptance Registers and Diaries.	Investments.	Investments Ledgers.
Indorsements and Guarantees.	Registers and Diaries.	Bills Discounted.	Bills Registers and Diaries.
Branches.	Branches Ledgers.	Loans to Customers.	Customers' Loans Ledgers.
Interest. Commission. Sundry Profits. Profit and Loss Account. Rebate on Bills Discounted.	These accounts are sometimes kept in detail in the General Ledger and sometimes in a subsidiary Profit and Loss Ledger. If the latter ledger is kept, the relative General Ledger Account replaces the individual accounts of profit and loss.	Bank Premises.	Premises Ledger.
		Customers' Liability for Acceptances.	Acceptance Ledgers or Registers.
		Customers' Liability for Indorsements and Guarantees.	Indorsements and Guarantees Ledgers or Registers.
		General Expenses.	See Notes against Profit Accounts.

GENERAL LEDGER.

CURRENT ACCOUNTS.

Date.	Dr.			Cr.			Balance.					
							Dr.			Cr.		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
19... Dec. 31				180,402,611	17	6				180,402,611	17	6
19... Jan. 1	4,625,279	16	2	5,514,211	12	6				181,291,543	13	10
,, 2	5,257,162	14	8	6,039,212	14	8				182,073,593	13	10
,, 3	8,110,302	14	9	10,051,216	14	3				184,014,507	13	4
,, 3	184,014,507	13	4									
	£202,007,252	18	11	202,007,252	18	11						
19... Jan. 3				184,014,507	13	4				184,014,507	13	4

Note.—The Current Accounts Ledgers Adjustment Account shown above has been closed and balanced as on January 3 for purposes of illustration; in actual practice the accounts in the General Ledger are ruled off at periodical intervals, *e.g.* monthly or half-yearly.

The Loamshire Bank, Limited.

GENERAL LEDGER TRIAL BALANCE, DECEMBER 31, 19...

	DR.			CR.		
	£	s.	d.	£	s.	d.
Share Capital, 1,000,000 shares of £10 each, £1 paid				1,000,000	0	0
Reserve Fund, invested in 5% War Loan				500,000	0	0
Current Accounts				15,122,111	14	9
Deposit Accounts				3,460,116	2	2
Acceptances for Customers				771,411	13	6
Indorsements and Guarantees				37,010	0	0
Cash	113,268	19	5			
Bank of England	1,006,049	13	2			
Foreign Correspondents	100,219	14	6			
Short Loans	3,241,028	9	2			
Investments	4,441,265	14	8			
Investments on account of Reserve Fund, 5% War Loan, 1929/47, £555,555 11*s.* 1*d.* Stock at 90	500,000	0	0			
Bills Discounted	3,114,122	19	3			
Loans and Advances to Customers	7,728,354	13	0			
Bank Premises	126,890	14	9			
Customers' liability for acceptances	771,411	13	6			
Indorsements and Guarantees per contra	37,010	0	0			
*Interest received				266,135	11	3
*Commission				22,126	19	8
*Discount				121,884	16	9
Profit and Loss Account, Balance brought forward				114,668	17	9
Interest paid	80,261	16	2			
General Expenses	91,212	14	9			
*Bad Debts written off	64,368	13	6			
	£21,415,465	15	10	£21 415,465	15	10

Note.—Reserve £32,184 6*s.* 9*d.* for rebate on bills discounted. The Profit and Loss Account balance is the balance left on that account after the payment of a dividend amounting to £100,000 on February 3, 19... It is not deemed desirable in the interests of the Bank to make public the totals of those Revenue Accounts marked *.

Day Book (Daily Summary) or General Cash Book.—This is a classified summary of the day's transactions, grouping together, on appropriate sides, the total entries for the day as they appear in the Cash Books, Journals, and other books of original entry. The General Ledger is posted from this book, a specimen of which appears on p. 750. Although frequently called a Cash Book, it will be noted that the book combines the functions of a Cash Book with those of a Journal.

Current Account Ledgers.—These are usually ruled as shown on p. 751 in cases where interest is allowed on current accounts or as shown on p. 752 when no interest is allowed.

GENERAL CASH BOOK.

	Details.			Folio.	Total.				Details.			Folio.	Total.		
	£	s.	d.		£	s.	d.		£	s.	d.		£	s.	d.
To Current Accounts, paid in .					199,261	14	8	By Current Accounts, cheques paid					84,321	6	0
,, Branches					11,926	12	4	,, Branches, payments made .					1,004	12	2
,, Bank of England, withdrawals					10,000	0	0	,, Bank of England, paid in .					101,119	11	1
,, Bills Discounted, per Diaries.					65,050	10	0	,, Customers' Loans made .					500	0	0
,, Customers' Loans paid off .					1,000	0	0	,, Deposit Receipts, withdrawals . . .					250	0	0
,, Deposit Accounts, paid in .					8,050	0	0	,, Short Loans made . .					150,000	0	0
,, Short Loans recalled . .					25,000	0	0	,, Acceptances, bills accepted.					80,000	0	0
,, Bills Payable, bills accepted .					80,000	0	0	,, Bills Payable, acceptances due					100,000	0	0
,, Acceptances, acceptances due					100,000	0	0	,, Interest Paid . . .					4	7	1
,, Cheque Stamps . . .					1	15	0	,, General Expenses . .					113	2	2
,, Interest Received, on Discounts	605	14	8					Total . . .					517,312	18	6
,, Interest Received, on Loans .	102	9	3		708	3	11	Cash Balance carried to succeeding day					18,810	9	7
,, Commissions . . .					110	0	0								
Total . . .					501,108	15	11								
Cash balance brought from previous day . . .					35,014	12	2								
					£536,123	8	1						£536,123	8	1

CURRENT ACCOUNT LEDGER (WITH INTEREST COLUMNS).

MESSRS. BANQUEROS HERMANOS, MALAGA.

Date.	Particulars.		Debit.			Credit.			Balance.			Days.	Product.	Rate.	Dr. Interest.			Cr. Interest.		
	Cheque No.	Payee.	£	s.	d.	£	s.	d.	£	s.	d.				£	s.	d.	£	s.	d.
19... Dec. 31	By Balance . .					2,222	5	6	2,222	5	6	1	2222							
19... Jan. 1	,, Cash . .					86	10	0												
,, 1	,, Cash . .					3	6	3												
,, 1	To 40008 . .	Wilson Jones	28	8	0															
,, 1	,, 40007 . .	R. Hays	11	6	6															
,, 1	,, 40009 . .	C. Palba	30	0	0				2,242	7	3	3	6726							
,, 4	,, 40012 . .	Institute X.Y.	1	13	0															
,, 4	,, 40010 . .	Mayfair Club	10	10	0				2,230	4	3	1	2230							
,, 5	,, 40011 . .	Brandt & Co.	4	17	10				2,225	6	5	1	2225							
,, 6	,, 40014 . .	Dr. Wright	3	3	0				2,222	3	5	1	2222							
,, 7	,, 40015 . .	Guardian Insurance	38	14	9															
,, 7	,, 40016 . .	Selves	7	0	0				2,176	8	8	5	10880							
,, 12	,, 40013 . .	Horace James, Ltd.	4	4	0				2,172	4	8	1	2172							
,, 13	,, 40017 . .	Meares Bros.	1	3	3				2,171	1	5	1	2171							
,, 14	,, 40001 . .	Selves	8	0	0				2,163	1	5	4	8652							
,, 18	By Interest to date					2	14	1					39500	2½				2	14	1
,, 18	To 40018 . .	Selves	2,165	15	6															
			£2,314	15	10	2,314	15	10												

CURRENT ACCOUNT LEDGER (WITHOUT INTEREST COLUMNS).

CHARLES HAWKES, 1312 BROWNDEAN ROAD, W.C.

Date.	Details.		Dr.			Cr.			Balance.		
	Cheque No.	Payee.	£	s.	d.	£	s.	d.	£	s.	d.
19...											
Dec. 31	By Balance					111	14	6	111	14	6
19...											
Jan. 1	,, Cash					24	2	6			
,, 1	,, Dividend on Indian Stock .					0	15	0	136	12	0
,, 1	To 12461	Bray	2	4	0						
,, 1	,, 12462	Wilding	11	6	0				123	2	0
,, 2	,, 12464	Self	5	0	0				118	2	0
,, 3	,, 12463	Commercial Union . .	1	11	2				116	10	10
,, 4	By Cash					2	11	2	119	2	0
,, 5	To 12465	Collieries, Ltd. . . .	10	0	0				109	2	0
,, 8	,, 12466	Pepys & Co. . . .	34	9	6				74	12	6
,, 9	,, 12467	Self	10	0	0				64	12	6
,, 10	,, 12468	Maitland	17	18	10				46	13	8
,, 10	,, Balance		46	13	8						
			£138	14	2	£138	14	2			
19...											
Jan. 10	By Balance					46	13	8	46	13	8

Note.—In the above example the account is shown as having been closed and balanced on January 10; in practice it is usual to rule off the accounts and bring down the balances at half-yearly intervals only.

If, in the latter ruling, only one "Balance" column is provided, debit balances are entered in red ink and credits in black ink. In some banks all ledger accounts are written up in triple column form, as shown in the current account on p. 752.

Received (Counter) Cash Book.—Each receiving cashier is provided with a Cash Book ruled as under:—

RECEIVED (COUNTER) CASH BOOK.

Money.			Notes.	Name.	Total of Credit.		
£	s.	d.			£	s.	d.
160	10	6	£50 10/5 327628/37	Child Bros.	210	10	6
15	0	0		Moore & Co.	115	0	0

Note.—The first entry represents a payment in of £210 10*s.* 6*d.* (£160 10*s.* 6*d.* coin and £50 in notes). The second entry represents a payment in of £115 (£15 in coin and £100 in cheques); it will be noticed that the cheques received are included in the total column but are not stated separately in this book.

The coin is placed by the cashier in his till, and the notes and cheques are pinned to the paying-in slip and passed over to the Waste-Book clerk seated immediately behind him. This clerk enters the items in his "Received Day Book," analysed according to the manner in which they will be collected by the Bank. The ruling of a Received Day book is shown on p. 754.

The notes are handed to special clerks to list and pay into the bank's account at the Bank of England, and the cheques are passed on to the clearing department for presentation at the London Bankers' Clearing House. Cheques on non-clearing banks go to the "Walks" department for collection by the "Walks" clerks. The paying slip itself is handed to the ledger keeper for posting.

The register recording transactions with the Bank of England is called the "Bank of England Book" or "Goldsmith's Book," a ruling of which is given on p. 754. Notes received by the Bank of England are not re-issued, but, after being cancelled, they are retained for seven years and then destroyed.

Deposits.—Banks accept cash on deposit at interest from customers, repayable at short notice, usually seven days, or at longer periods of notice as may be agreed between banker and customer. The interest allowed on deposits varies with the bank rate, and for deposits at short notice would be at the rate of 2% below bank rate. Customers frequently transfer amounts from current to deposit account, in cases where their cash accumulates beyond their immediate needs. Such transfers are made by dockets and are recorded in a separate Deposit Register, containing the same information as illustrated in the Deposits

RECEIVED DAY BOOK (WASTE BOOK).

Name.	Total Amount.			Details.																				
				Town Clearing.			Metropolitan Clearing.			Walks.			Bank and Country Notes.			Bank of England.			House (own) and Country Cheques.			Money.		
	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
Child Bros.	210	10	6										50	0	0							160	10	6
Moore & Co.	115	0	0	10	0	0	20	0	0	10	0	0				30	0	0	30	0	0	15	0	0

Note. The entries given above correspond to those given in the Received Cash Book. The £100 in cheques paid in by Moore & Co. has been analysed according to the Bankers upon whom the cheques were drawn, viz. £10 Town Clearing, £20 Metropolitan, £10 Walks, £30 Bank of England cheques, and £30 country cheques. In some forms of Waste Book the money and bank-notes entered on the paying-in slips are not recorded, the book being restricted in its use to the cheques paid in. The Waste Book is by some regarded as the successor of the Goldsmith's Book used in the earlier days of banking.

BANK OF ENGLAND BOOK (ALSO CALLED GOLDSMITH'S BOOK).

Paid in.																		Withdrawn.				
Date.	Details.	Gold.			Notes.			Post Bills.			Bank of England Cheques.			Folio.	Total.			Details.	Folio.	Total.		
		£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.		£	s.	d.			£	s.	d.
19... June 5	Receiving Cashiers				1,500	0	0	25	0	0	100	0	0		1,625	0	0	Notes		100	0	0
" 5	Clearing							10	0	0	1,000	0	0		1,010	0	0	Gold		1,000	0	0
																		Silver		50	0	0
					£1,500	0	0	£35	0	0	£1,100	0	0		£2,635	0	0			£1,150	0	0

Diary given below. Deposit receipts are sometimes issued to customers. These are neither transferable nor negotiable. Usually, however, all transactions on deposit account are recorded in a Deposit Account Pass Book. Deposits received are recorded in the books of the bank's receiving cashiers, and dockets are made out and entered in the Deposits Diary ruled as follows:—

DEPOSITS DIARY.

Date.	Customer's Name.	Interest Rate.	Folio.	Amount.			Due Date.	Repaid Date.
				£	s.	d.		

When deposits are repaid, they are passed through the paying cashier's books, and the Deposits Paid Register. If deposits are retransferred to Current Account, dockets are made out and entered in the Deposits Register, and the Customers' Deposit Accounts are debited and their Current Account credited. All deposits are posted to the Deposits Ledger, ruled in parallel columns to record the deposits, withdrawals, balances, number of days, interest, etc.

Paying Cashier's Counter Cash Books.—Each paying cashier is provided with a Cash Book ruled as under:—

PAYING CASHIER'S COUNTER CASH BOOK.

(Supplementary Paid Cash Book.)

Total.			Name.	Numbers of Bank-notes.	Amount of Notes.			Money.		
£	s.	d.			£	s.	d.	£	s.	d.
35	0	0	C. Wrayson . . .	226121/3 3/5	15	0	0	20	0	0
5	0	0	W. Higgins . . .					5	0	0
10	0	0	C. Meyer	13298 1/10	10	0	0			

Before paying a cheque, the cashier scrutinises the signature or signatures to the cheque, and the indorsements, if any, and satisfies himself that they purport to be correct and in order. If he is in doubt as to the genuineness of the customer's signature, he compares it with the specimen signature of the customer in the bank's signature book; and if there is any doubt as to the customer's balance being sufficient to meet the cheque, he refers to the customer's current account in the ledger. All paid cheques are entered at the time of paying in the Paid Cash Book, illustrated as follows:—

PAID CASH BOOK.

Name.	Waste Book.			Walks.			Paid Cashiers.		
	£	s.	d.	£	s.	d.	£	s.	d.
C. Wrayson							35	0	0
W. Higgins							5	0	0
C. Meyer							10	0	0

The totals of the Paid Cash Book are entered, at the close of the day's business, on the credit side of the General Cash Book, and are from there posted to the General Ledger.

Bills of Exchange.—These occasion a very large but diminishing proportion of the book-keeping work of a bank. The cheque is the most popular instrument of payment, but the bill payable after sight or date plays a very important part in the settlement both of home and international indebtedness. The wholesale dealer requires cash; the retailer wants credit, and both requirements are satisfied by the creditor drawing, the debtor accepting, and the banker discounting a bill of exchange payable on a future date. Bills of exchange received by a banker for collection are termed *short bills*, or *bills for collection.* In foreign-exchange transactions, any bill with not more than ten days to run before it reaches maturity is a short bill. Bills with unexpired currencies for periods up to six months are termed long bills.

BILL DIARY.

Ledger Folio.	Acceptor.	Folio.	For Whose Credit at Maturity.	£	s.	d.
	Clutterbuck Bros., Ltd. . .		Miles & Co.	500	0	0
	Butterworth & Sons, Ltd. .		A. Brown	1,000	0	0
	Measonthwaite & Co. . .		C. Day	250	0	0
	A. Child & Co. . . .		B. Wray	10	0	0
				£1,760	0	0

Note.—The total (£1,760) is entered in the Cash Book for the day as a debit, and the various customers are credited either direct from the diary or from credit slips made out to correspond with the entries it contains.

A banker who discounts a bill is holder of the bill for value. The customer must indorse the bill in blank before the banker will discount it, and then it becomes the banker's property. Discounted bills are kept apart from bills paid in for collection, and treated separately in the banker's books.

Short bills handed in for collection are attached to special paying-in slips and are handed to the bill office for record and collection. A small commission is charged for clearing Scotch and Irish bills. The bills are entered in specially ruled diaries according to their due dates. The maturities of each day are presented for payment. The receiving cashiers' books are debited with the total bills due for collection, and the customers' current accounts are credited. A form of Bill Diary is given above.

BILL LEDGER.

CHARLES MARSHALL & CO.

Date.	When Due.	Amount.			Acceptor.	Dr.			Cr.			Balance.		
		£	s.	d.		£	s.	d.	£	s.	d.	£	s.	d.
19... April 1	April 20	100	0	0	Child & Co.									
	May 31	150	0	0	Brown & Co.									
	June 26	80	0	0	Robinson & Co.				330	0	0	330	0	0

Note.—As the Bills are paid they will be debited in this ledger from the Bill Diary, and the amount in the Balance column will be adjusted accordingly.

BILLS DISCOUNTED REGISTER.

(DISCOUNT REGISTER.)

No.	Date.	Name.	Drawer.	Payee.	Acceptor.	Date of Bill.	Tenor.	When Due.	Amount.			Total.			Discount.						Remarks.
															Days to Run.	Rate.	Dis-count.	Total of Discount.			
									£	s.	d.	£	s.	d.				£	s.	d.	
3250	19... June 1	W. Brown	Smith	A. King	National Bank of S. Africa, London	May 10, 19...	3 months	Aug. 13				150	0	0	73	4%		1	4	0	Paid
3251	June 1	Roberts Bros.	Selves	Selves	Hosier & Co.	Mar. 12, 19...	3 months	Aug. 15	500	0	0				75						Paid
3252	June 1	Roberts Bros.	Selves	Selves	C. Ray	May 14, 19...	3 months	Aug. 17	200	0	0	700	0	0	77			5	15	10	Rebated

A suitably ruled Bill Ledger, with an account for each customer, is also kept, the ruling of which is shown on p. 757.

The outstanding balances in the Bill Ledger should agree, at any time, with the like information extracted from the Bill Diaries.

When bills are purchased (discounted), the bank records them in a Bills Discounted Register, a ruling of which appears on p. 757. They are also entered in a Bills Discounted Diary similar in form to that already given on p. 756. In order to keep a check upon the bills purchased from any one customer, a memorandum Discount Ledger is also kept. The " maximum " limit of accommodation fixed (if any) is recorded at the head of the customer's account.

When bills are discounted, posting slips are prepared crediting the customer with the face value of the bill, and debiting him with the discount charged, through the General Cash Book, and the General Ledger, " Bills Discounted Account " is debited with the daily total of the bills purchased, and Discount Account is credited with the total discount charged. When the bills mature, the cash books are debited, and Bills Discounted Account is credited with the total of the bills due each day as explained in the case of short bills.

Acceptances.—Banks undertake to accept bills on behalf of customers who are required to satisfy foreign exporters that the bills drawn upon them by those exporters will be duly paid. Customers so accommodated are charged a commission. Bills so accepted are entered in an Advice Book and an Acceptances Register containing full details of each acceptance. Acceptance Diaries are also kept, similar in form to the Bill Diary already described and illustrated. A memorandum Acceptance Ledger is also kept containing an account for each customer for whom bills have been accepted. The customer is debited with the bank's acceptances on his behalf, and credited as and when he pays the bills. These accounts therefore show at any time the acceptances outstanding on behalf of customers individually and collectively. The ruling of an Acceptance Ledger is given above.

ACCEPTANCE LEDGER.

BANK OF IDAHO.

Date Accepted.	Date Due.	Number.		Dr.			Cr.			Balance.		
		Of Credit.	Of Bill.	£	s.	d.	£	s.	d.	£	s.	d.
19...												
Mar. 1	June 4	3256	1421	200	0	0				200	0	0
	June 4	Due	Due				200	0	0			

Securities.—Customers frequently deposit securities and other valuables with their bankers for safe custody; and, in the case of bearer

SECURITIES RECEIVED REGISTER.

Date Received.	Received for Account of	Amount of Security.	Description.	Securities Ledger Folio.	Received from
19...		£			
June 10	A. Kaye	1,000	Belgian 3% Loan, 1914	1442	Hirst Bros.
June 12	A. Kaye	100	Budapest 4½% Loan 1914 Scrip	1442	Hirst Bros.

Note.—The Securities Delivered Register is ruled in similar manner, the headings being altered to correspond.

LOANS LEDGER.

Charles Melville, 1888 Upper James's Street, S.W.

Date.	Dr. Loan Made.			Cr. Loan Repaid.			Balance.			Interest.						Particulars of Security Held.	Value of Security.			Disposition of Security and Remarks.
										Days.	Product.	Rate.								
19...	£	s.	d.	£	s.	d.	£	s.	d.				£	s.	d.		£	s.	d.	
Jan. 1	1,000	0	0				1,000	0	0	56	56,000	5	7	13	5	£1,000 Japanese Government 4½% 1st series	1,000	0	0	Transferred to securities held for sale custody on repayment of loan.
Feb. 26				1,000	0	0										£500 Brazil 5% Fdg.	430	0	0	

securities, request the banker to detach the interest coupons as they fall due, and collect them on their behalf, and also to notify them should any of the bonds be advertised as having been drawn for redemption. As a rule, bankers perform this service for their customers gratuitously. A banker has no lien on securities or other valuables deposited for safe custody, unless a lien be specially created. But where the banker detaches and collects coupons attached to securities, it would appear that he has a constructive lien on the securities to the extent of any moneys due to him, or that may become due to him, from the customer for whom he so acts, so long as they are in his custody.

Securities thus held for safe custody are recorded in a Securities Received Register, as illustrated on p. 759.

A memorandum Securities Ledger is also kept containing an account for each customer who deposits securities, in which a full description of the securities lodged and withdrawn is recorded.

Where the securities or other valuables lodged for safe custody are contained in locked boxes, the banker takes no cognisance of the contents of the boxes.

Loans to Customers.—Loans made to customers, and the interest accruing thereon, are posted by means of dockets, as already illustrated, and details are recorded in the Loans Ledger, in which an account for each borrower is kept, recording full details of loans made and the security deposited as cover. The ruling of a Loans Ledger is given on p. 759.

Where overdrafts are allowed on current accounts, the maximum credit allowed is recorded at the head of the customers' ledger account.

Banks do not advance loans for indefinite periods. A Loans Diary is therefore kept recording the fixed due dates of all loans.

EXAMINATION QUESTIONS.

1. A banking institution has accepted bills drawn upon them on behalf of customers, payment to be provided for by the latter on or before maturity; state how the respective responsibilities of the Bank and of its customers should be stated in the Balance Sheet of the Bank. (*Chartered Accountants.*)

2. On November 15 the Loamshire Bank, Ltd., purchased a two months' bill for £100, dated October 30, drawn by William Archer and accepted by George Shaw. State the entries which the Bank would make when recording this transaction, and give the ruling of one of the books named by you as employed by the Bank. (*Royal Society Arts.*)

3. Explain briefly the methods employed in order to keep the books of a Bank constantly posted.

On July 31, George Reimers paid in the following to his Bank in the City: Cheque (Geo. Smith, London), £15; Cheque (Robt. Robinson, London), £20; Gold, £10; Bank of England Notes, £20.

Describe the passage of the above items through the books of the Bank from the moment of their receipt until credited to the account of George Reimers. (*Royal Society of Arts.*)

4. R. Craven opens a bank account on January 1 with the Rosedale Banking Company, and deposits on that date £1,000. He pays in as follows: January 20, £500; March 20, £600; May 20, £700; and he draws out on February 20 £1,200, on April 20 £1,000, and on June 20 £500. Calculate the Bank Interest,

counting 5% on customer's debit balances and 2% on credit balances, and close the account on June 30. (*Incorporated Accountants.*)

5. Define the term "Bank Rate," and show how the level of Bank Rate affects that of other interest rates. (*Chartered Accountants.*)

6. Indicate the principal sources of profit accruing to a joint-stock bank carrying on business in England and Wales. (*Chartered Accountants.*)

7. Give two alternative rulings suitable for the Current Accounts Ledger of a Bank. From what materials are these ledgers written up? (*Royal Society Arts.*)

8. On January 25, John Smith called at the Union Bank of London and paid in the following:—

	£
Gold	25
Bank of England Notes	50
Cheque drawn on the Old Bank, York	62
Cheque drawn on the Joint Stock Bank, Princes Street, E.C.	41
	£178

Trace the history of the above items as they would appear in the books of the Union Bank of London. (*Royal Society Arts.*)

9. I paid into my Current Account with the National and Provincial Bank, Ltd., on October 19, the following:—

	£	s.	d.
Gold Coin	5	0	0
Silver and Copper Coin	0	15	9
Bank of England Notes	10	0	0
Cheque on the Bank of England	15	12	6
Town Cheques on various Banks	39	14	2
Cheque on the National and Provincial Bank, Ltd.	16	2	4
	£87	4	9

Rule the following forms and enter therein the foregoing items as far as the various forms are concerned: (1) Paying-in Slips; (2) Receiving Cashier's Counter Cash Book; (3) Received Waste Book; (4) Bank of England Book. (*London Chamber Commerce.*)

10. I drew a cheque on my Current Account for £55, which I presented for payment across the counter, taking £5 in gold, £5 in silver, and the remainder in £5 Bank of England notes.

Rule a form of Paying Cashier's Counter Cash Book, and enter in it the foregoing transactions. (*Royal Society Arts.*)

11. Give a ruling suitable for use in the Current Accounts Ledger of a Bank. Enter six specimen transactions therein; and explain the advantages of the form you advocate. (*London Chamber Commerce.*)

12. Describe the principal books of account (not more than six) used in Banking. (*Chartered Accountants.*)

13. Explain the meaning of the following items extracted from the Balance Sheet of a Bank: (*a*) Rebate on Bills not due (liability side); (*b*) Money on short notice (assets side); (*c*) Liabilities of customers on acceptances as per contra (assets side); (*d*) Liabilities by indorsement on foreign bills sold (liabilities side). (*Chartered Institute Secretaries.*)

14. Describe the ordinary routine of discounting a bill of exchange, the entries to be made in the bank's books, and the nature of the enquiries necessary. (*Chartered Secretaries.*)

15. After writing up the Profit and Loss Account, the General Ledger balances of the Conservative Bank, Ltd., as on December 31, were as follows: Paid-up Capital, £1,500,000; Cash at Bank of England and in hand, £2,600,980; Custo-

rs' Current and Deposit Accounts, £17,580,000; Bills Discounted, Loans and vances, £14,482,000; Freehold Premises, £380,000; Rebate on Bills Dis- unted, not yet due, carried to next account, £24,300; Reserve Fund, £1,200,000; glish Government Securities, £1,250,000; Other Government Securities, 20,000; Profit and Loss Account (undistributed balance), £110,680; Securities dged with public bodies, £81,000; Indian and Colonial Securities, £1,101,000. the same date (December 31) the acceptances on behalf of customers, and for ich they were liable, appeared in the Acceptance Book of the Bank at ,725,420. Prepare a Balance Sheet as on December 31. (*London Chamber mmerce.*)

16. From the following figures prepare the Profit and Loss Account and alance Sheet of the B. C. Banking Company, Ltd., at December 31: Capital, ,000,000; Reserve Fund, £1,000,000; Cash at Head Office, Branches and Bank England, £4,685,459 14*s.* 1*d.*; Loans at Call, £2,920,183 14*s.* 8*d.*; Interest paid Customers, £67,599 11*s.* 7*d.*; Profit and Loss Account Balance, June 30, 916, £61,685 12*s.*; Investments: Consols, £6,950,248 17*s.* 1*d.*; Colonial Stock, 950,127 3*s.* 9*d.*; Corporation Stock, £1,209,246 18*s.*; Other Securities, £12,732 1*s.* 5*d.*; Salaries and Expenses, £217,196 11*s.* 6*d.*; Current and Deposit Accounts, 34,450,116 7*s.* 10*d.*; Liabilities on Acceptances, £3,234,502 18*s.* 6*d.*; Dis- ounted Bills Current, £10,140,079 14*s.* 4*d.*; Advances to Customers, £10,434,135 2*s.* 4*d.*; Rebates on Bills not due carried to next Account (debit Profit and Loss ccount), £27,207 6*s.* 2*d.*; Liabilities of Customers for drafts accepted by the Bank (as per contra), £3,234,502 18*s.* 6*d.*; Freehold Premises, Fixtures, and Fit- ings, £488,127 5*s.* 2*d.*; Amount now written off Premises Account, £20,000; ross Profit for Half-year, £553,335 14*s.* 1*d.* (*Incorporated Accountants.*)

17. From the following particulars prepare the Profit and Loss Account for he half-year ended December 31 and Balance Sheet at that date of the Security Banking Company, Ltd. Before doing so transfer £50,000 to Reserve Account nd write off £30,000 from Premises Account; bring into account Rebate on Bills iscounted, £40,600, and Acceptances on Account of Customers, £1,560,000.

Investments in British Government Securities, £6,530,220; Advances to ustomers, £20,840,450; Current and Deposit Accounts, £50,308,730; Cash n hand and at Bank of England, £7,560,680; Salaries and all Expenses, including uditors' and Directors' Fees, £300,880; Profit and Loss Account, Cr. Balance t July 1, £00,890; Bank Premises, £630,000; Investment in India Government Securities, Guaranteed Stock and Debentures, £3,566,840; Loans at Call and Short Notice, £3,740,530; Reserve Fund, £2,500,000; Investment in Metropolitan and other Corporation Stocks, £1,876,540; Discounted Bills, £8,940,570; Interest Paid to Customers, £160,830; Capital Subscribed, £4,000,000—Paid up, £1,000,000; Gross Profit, £548,420; Investments in "Other Securities," £300,500.

18. Draw up a rough Balance Sheet of an English joint-stock bank (other than the Bank of England) and explain the significance of the items included in it. (*Chartered Secretaries.*)

CHAPTER XXI

BILLS OF EXCHANGE. CHEQUES. PROMISSORY NOTES

[*Note.*—The references throughout this section are to the *Bills of Exchange Act*, 1882, unless otherwise stated.]

THE law governing Bills of Exchange, Cheques, and Promissory Notes is contained in the following Statutes: The *Bills of Exchange Act*, 1882; the *Bills of Exchange (Crossed Cheques) Act*, 1917; and the *Bills of Exchange (Time of Noting) Act*, 1917. The rules in bankruptcy relating to these instruments continue to apply thereto, notwithstanding anything contained in these Acts, and so also do the rules of common law * and the law merchant,† in so far as they are not inconsistent with any of the express provisions of the Acts.

Bills of Exchange, Cheques, and Promissory Notes belong to that imited but highly important class of commercial documents known s *Negotiable Instruments*. A negotiable instrument is a document ontaining a contract to the ownership of which document are attached ll rights under the contract. The *bona-fide* possessor of such a document s presumed to be the lawful owner of it. The document with all the ights conferred by it can be transferred by one person to another, ometimes by mere delivery, sometimes by delivery accompanied by ndorsement of the document, and the person to whom it is transferred, rovided that he takes it in good faith, takes it free from any rights hat could be enforced against the transferor, and free from any defect the transferor's title to the document. It will be seen that negotiable nstruments are an exception to the general rule of law that one party o a contract cannot assign his rights under the contract to a third arty, except subject to any existing rights which the other party to e contract may have against him.

Examples of negotiable instruments are: Bank-notes, Bills of xchange, Cheques, Promissory Notes, Dividend Warrants, Exchequer onds, Debentures payable to bearer. A Bill of Lading has some of e qualities of a negotiable instrument, but it is not a fully negotiable strument, because no one who takes a bill of lading can acquire a better title to the goods represented by it than has the person who transfers it.

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* The Common Law is that great body of law which has never been formally acted by any legislative power, but is founded upon tradition and the immeorial and general custom of the realm, as interpreted by the judges. Since it does t originate in any formal enactment it is often called "the unwritten law." atute Law consists of Acts of Parliament, and is often called "the written law," contradistinction from the Common Law (Disney, *Elements of Commercial Law*, 1).

† The Law Merchant resembles the Common Law in being unwritten, but it ends on commercial usage, which having become universal is recognised by the urts as binding, but which may be of modern origin (Disney, *op. cit.*, p. 1).

I. Bills of Exchange.

Uses of the Bill of Exchange.

(*a*) It affords a cheap and safe means of remittance, avoiding the transfer of actual cash. Since a bill of exchange may be freely negotiated, the same bill may effect many transfers of funds, and so settle many debts, before it is finally discharged.

(*b*) It is a great instrument of credit, enabling the seller of goods to give credit to the buyer, and at the same time obtain ready cash for himself. For example: A manufacturer sells to a merchant £100 worth of goods, one of the conditions of sale being that the buyer shall accept the seller's bill of exchange payable three months after date for the price of the goods. The seller draws, and the buyer accepts, the bill. The seller then indorses the bill in blank, takes it to his banker, who discounts the bill. That is, the banker immediately credits his customer's account with the amount of the bill, less the charge for discounting. If discount rate were 6% p.a., the amount credited would be £100 less ¼ of £6 = £98 10s. If the bill be duly paid at maturity, the banker retains the £100; if it be not paid, he returns the bill to the customer and debits him with £100, plus any expenses incurred. Alternatively, where the circumstances warrant such a step, the banker retains the bill, and sues as holder for value, the parties to the bill.

(*c*) An accepted bill of exchange is better evidence of debt than an ordinary open book debt. In the first place, a bill fixes the date of payment. Secondly, if a debtor is sued for recovery of an open book debt, he may defend the action on any ground available to him. But if he has accepted a bill of exchange for the amount, then, provided he has received due consideration for his acceptance, he has no defence if he dishonours the bill. The drawer may apply for summary jurisdiction, since the damages upon dishonour are liquidated damages (*see* p. 777).

Legal Definition of Bill of Exchange.—A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person or to bearer (S. 3 [1]). An instrument that does not comply with these conditions, or which orders any act to be done in addition to the payment of money, is not a bill of exchange (S. 3 [2]).

The points to note about the above definition are that to be a bill of exchange the instrument must be:—

(*a*) " An order." Not a prayer or entreaty but a command.

(*b*) " Unconditional." An order to pay out of a particular fund is not unconditional, but an unqualified order to pay, coupled with an indication of a particular fund out of which the drawee is to reimburse himself, or a particular account to be debited with the amount; or a statement of the transaction which gives rise to the bill, is unconditional (S. 1 (3)).

(*c*) "In writing." Writing includes print and typewriting.

(*d*) "Addressed by one person to another." The word "person" includes a body of persons whether incorporated or not (S. 2). The person addressing the order is called the *drawer*; the person to whom the order is addressed is termed *the drawee.* The drawee must be named or otherwise indicated in a bill with reasonable certainty. A bill may be addressed to two or more drawees whether they are partners or not, but an order addressed to two drawees in the alternative, or to two or more drawees in succession is not a bill of exchange (S. 6).

(*e*) "Signed by the person giving it." It is not necessary that the drawer should append his signature to the order at the time of making it. He may do so subsequently after acceptance, but until he does, the instrument is inchoate, *i.e.* incomplete. The drawer need not sign the order by his own hand; he may do so by his agent duly appointed for the purpose.

(*f*) "Requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time." A bill is payable on demand, when it is expressed to be so payable, or expressed to be payable "at sight," or "on presentation," or when no time for payment is expressed, or when a bill is overdue and it is then accepted or indorsed (S. 10). "Fixed Time," *i.e.* when a bill is expressed to be payable on a specific future date, *e.g.* "On the 30th September, 19— fixed pay." "Determinable future time," *i.e.* when a bill is expressed to be payable at a fixed period after date or sight, *e.g.* "Sixty days after sight pay," or "Three months after date pay"; or on, or at a fixed period after, the occurrence of a specified event that is bound to happen, *e.g.* "One year after my death pay." But an instrument drawn payable on or after the occurrence of a specified event that may or may not happen is not a bill of exchange, since no bill can be made payable on a contingency. Thus to draw an instrument in the following terms, "On the arrival of the s.s. *Cormorant* at Southampton pay" is not a bill of exchange, since the *Cormorant* may never arrive at Southampton (S. 11).

(*g*) "A sum certain in money." The sum may be expressed to be payable with interest; or by stated instalments; or by stated instalments with a provision that upon default in payment of any instalment the whole shall become due; or according to an indicated rate of exchange, or a rate of exchange to be ascertained as directed by the bill. Where in a bill the words and figures differ in amount, the amount indicated by the words is the sum payable; and where a bill is payable with interest, unless the instrument otherwise provides, interest runs from the date of the bill, or if it is undated from the issue thereof (S. 9). A bill is not invalid by reason that it is not dated, or ante-dated, or post-dated, or that it bears date on a Sunday (S. 3 (4)). And where a bill expressed to be payable at a fixed period after date is undated, or where the acceptance of a bill payable at a fixed period after sight is undated, any holder may insert what he, in good faith, believes to be the true date of issue or acceptance, and the bill shall be payable accordingly (S. 12).

(*h*) "To or to the order of a specified person." The specified person is termed the *payee* of the bill. A bill is payable to order which is expressed to be so payable, or which is expressed to be payable to a particular person, and does not contain words prohibiting transfer or indicating an intention that it should not be transferable (S. 8 [4]). The payee must be named or otherwise indicated therein with reasonable certainty. A bill may be made payable to two or more payees jointly, or in the alternative to one of two, or one or some of several payees. A bill may also be made payable to the holder of an office for the time being, *e.g.* "Pay to the Secretary of the Gas Light and Coke Company" (S. 7).

(*i*) "Or to bearer." A bill is payable to bearer which is expressed to be so payable, or on which the only or last indorsement is an indorsement in blank (S. 8 [3]). Where the payee is a fictitious or non-existing person the bill may be treated as payable to bearer (S. 7).

There are thus primarily three parties to a bill of exchange, viz. drawer, drawee, and payee. But frequently the drawer and the payee are the same person, because the drawer directs payment to be made to himself—"Pay to me [us] or my [our] order." And the drawer and the drawee may be the same person. In the latter case, the holder may treat the instrument, at his option, either as a bill of exchange or a promissory note (S. 5 [2]).

It will be noted that throughout the above legal definition the stress is upon the *certainty* of the instrument. A bill of exchange is evidence of a debt and security for its repayment. It is clear that if an order purporting to be a bill of exchange was encumbered with conditions; or the sum payable, or the time of payment, or the person by whom or to whom payment was to be made was uncertain; or if payment was coupled with, or made contingent upon, the performance of acts other than the payment of the sum expressed to be payable, it would be practically useless as an instrument of credit designed for general negotiation.

The following illustrate common types of bills:—

£300.

London, 8 John Street, W.C.1.
January 15, 19...

2*d*.

On demand pay bearer the sum of Three Hundred Pounds value received.

Sims, Woodhead & Co.

To Mr. Robert Hudson,
18 Boar Lane,
Leeds.

The above is an example of an inland bill payable not to a specifi person but to bearer. The bearer may be Sims, Woodhead & Co., any person to whom the bill may be negotiated, or the holder of t bill. A bill payable to bearer may be negotiated merely by delive The expression "Value received" is commonly used on bills, but it immaterial whether the words are added or not, since every par whose signature appears on a bill is *prima facie* deemed to ha become a party thereto for value (S. 30 [1]). The contrary h to be proved. For the stamp duty on bills, cheques, and promisso notes *see* p. 769.

£500.

LONDON, 8 JOHN STREET, W.C. 1.
January 15, 19...

5*s.*

Three months after date pay to Messrs. Soames and Walker the sum of Five Hundred Pounds value received.

per pro. HOWARD AND FRANCIS, LTD.,
F. WATKINSON, *Director.*

To MESSRS. BALL & CO.,
18 QUEEN STREET,
CARDIFF.

The above is an example of an inland bill drawn at a determinab future time and payable to a specified person. The effect of drawin a bill payable to A. B. is the same as if it had been drawn payable t

£250.

LONDON, 8 JOHN STREET, W.C. 1.
January 15, 19...

3*s.*

One month after sight pay to us or our order the sum of Two Hundred and Fifty Pounds value received.

J. J. MANISTY & CO.

To the MANITONE CO., LTD.,
BRITANNIA WORKS,
SOUTHALL.

A. B. or order, or the order of A. B., *i.e.* the bill must be negotiated b indorsement and delivery.

The third bill illustrated above is an example of an inland bill draw at a determinable future time and payable to a specified person, bu where drawer and payee are the same person. [*Note.*—Inland bills ar not usually drawn after sight, but either on demand, or after date.]

£276 : 10 : 9.

London, 8 John Street, W.C. 1.
January 15, 19...

3s.

Sixty days after sight pay this First of Exchange (Second and Third of the same tenor and date unpaid) to the order of The Westminster Bank, Limited, the sum of Two Hundred and Seventy-Six Pounds Ten Shillings and Ninepence value received.

Alan, Borthwick & Co.

To Messrs. Charles Howard's Sons,
16 Fifth Avenue,
New York.

£600.

London, 8 John Street, W.C. 1.
January 15, 19...

6s.

Ninety days after date of this First of Exchange (Second and Third of the same tenor and date unpaid) pay to our order the sum of Six Hundred Pounds value received. Exchange as per indorsement.

Langworthy & Company.

To Messrs. B. X. Furtado y Cia,
Corrientes 576,
Buenos Aires.

£725.

London, 8 John Street, W.C. 1.
January 15, 19...

8s.

Ninety days after sight of this First of Exchange (Second and Third of the same tenor and date unpaid) pay to the order of The National Bank of India, Limited, the sum of Seven Hundred and Twenty-Five Pounds. Payable at the National Bank of India's drawing rate for demand drafts on London, together with interest at six per cent. per annum from date hereof to approximate due date of the arrival of the remittance in London. Documents to be surrendered on acceptance.

J. J. Sanderson & Co.

To Messrs. Chundra, Dutt & Co.,
Esplanade Row,
Madras.

The three bills illustrated above are all foreign bills, the first being a clean bill, *i.e.* without shipping documents attached to it, the second a clean bill payable at a rate of exchange to be ascertained as directed by the bill, the third a documentary bill payable at a specified rate of exchange, together with interest as directed by the bill, the shipping documents to be surrendered to the drawees on their accepting the bill.

Exchange as per Indorsement.—The rate of exchange at which the bill is to be paid is usually indicated by a London banker or bill broker, who converts the bill at the time it is sold to him by the drawer at such a rate as will produce for the seller the exact sterling amount of the bill. The indorsement takes the following form: "Pay —— or order at the rate of —— per £1 sterling." The amount converted into foreign currency at the rate indicated is then written below the sterling figures on the face of the bill, and that is the amount in foreign currency to be paid by the drawee. In this way, the English drawer is relieved of any question of loss or gain from fluctuations in the rate of exchange. The drawer advises his drawee of the conversion rate. This phrase is not so commonly used on bills as it was before our British banks and financial houses took up the business of foreign-exchange dealing.

Inland and Foreign Bills.—There are two classes of bills: (*a*) inland, (*b*) foreign bills. An inland bill is a bill which is or on the face of it purports to be both drawn and payable within the British Islands, or is drawn within the British Islands upon some person resident thereon (but not necessarily payable therein). Any other bill is a foreign bill. "British Islands" mean any part of the United Kingdom of Great Britain and Ireland, the islands of Man, Guernsey, Jersey, Alderney and Sark, and the islands adjacent to any of them being part of the dominions of His Majesty (S. 4 (1)).

Stamp Duty on Bills and Notes.—By the *Stamp Act*, 1891, amended by the *Finance Act*, 1899, and the *Finance Act*, 1918, the stamp duties on bills and notes are as follows:

	s.	d.
Bill of Exchange payable on demand or at sight, or on presentation, or within three days after date or sight, for any amount.	0	2
Bill of Exchange of any other kind whatsoever (except a bank note) and Promissory Notes of any kind whatsoever (except a bank note) drawn, or expressed to be payable, or actually paid or indorsed, or in any manner negotiated in the United Kingdom:—		
Where the amount or value of the money for which the bill or note is drawn or made does not exceed £5	0	2
Exceeds £5 and does not exceed £10.	0	2
,, £10 ,, ,, £25.	0	3
,, £25 ,, ,, £50.	0	6
,, £50 ,, ,, £75.	0	9
,, £75 ,, ,, £100.	1	0
For every £100, and also for any fractional part of £100 of such amount or value	1	0

By S. 10 of the *Finance Act*, 1899, where a bill of exchange is drawn and expressed to be payable out of the United Kingdom, and is actually paid or indorsed or in any manner negotiated in the United Kingdom, and the amount for which the bill is drawn exceeds £50, the stamp duties are reduced as follows:—

Exceeding £50 and not exceeding £100	6*d*.
Exceeding £100, for every £100 and fractional part of £100 .	6*d*.

The stamp on bills payable on demand, or at sight, or on presentation, or within three days after date or sight may be adhesive or impressed, and a twopenny postage stamp or two penny postage stamps may be used for the purpose. All other bills and notes must be drawn on paper impressed before issue with the "bill or note" stamps appropriated to that use, to the required amount of the duty.

Foreign-drawn bills if payable on demand or at sight or on presentation or within three days after date or sight may be stamped with an ordinary twopenny postage stamp or with two penny postage stamps. But all other such bills, and all foreign-drawn notes must be stamped *ad valorem* with the special adhesive "foreign bill or note stamps" appropriated to this purpose. For stamping purposes, a bill of exchange or promissory note which purports to be drawn or made out of the United Kingdom is to be deemed to have been so drawn or made, although it may in fact have been drawn or made within the United Kingdom. The Channel Islands and the Isle of Man are regarded as foreign countries so far as stamp duty is concerned, and bills and notes drawn or made therein require stamping as foreign-drawn bills or notes. In all other respects such bills and notes are inland bills and notes.

Acceptance of Bill.—With the exception of the first bill illustrated on p. 766, which is drawn payable on demand, and which, therefore, is presented to the drawee but once and that for payment, all the other bills will, in accordance with commercial practice, first be presented to the drawees as soon as possible for acceptance, and after acceptance be again presented to the drawees (now the acceptors) on the due dates for payment.

A bill is presented for acceptance in order to make the drawee a party liable on the bill, and so render it the more easily negotiable. Clearly, any person could write out an order calling upon another person to pay a sum of money, but until that other person has assented to the drawer's order upon him, he is under no liability on the bill. But the bill is perfectly valid without acceptance, and the drawer is liable to any person who may become a party to the bill by indorsement in the course of its negotiation prior to acceptance, and so also is any indorser of such a bill to a subsequent indorser, or to the holder.

S. 39 of the Act mentions three instances where the holder of a bill *must* present it for acceptance, viz. (*a*) where a bill is payable after sight. This is necessary in order to fix the day of payment, (*b*) where the bill expressly states that it shall be presented for acceptance, (*c*) where a bill is drawn payable elsewhere than at the residence or place of business of the drawee. But, as already stated, it is the usual commercial practice to obtain acceptance of all bills not payable on demand at the earliest possible moment.

Form of Acceptance.—The drawee of a bill assents to the drawer's order upon him by writing across the face of the bill the word "accepted," and underneath that word his signature. He need not himself sign the bill; he may accept the bill by the hand of his agent duly authorised for that purpose. The word "accepted" is not really necessary, although it is invariably used. The signature is the vital thing that constitutes assent. The acceptances of the bills—illustrations 1 and 4 above—would take the following forms:—

Sighted, January 25, 19...
Accepted.
Payable at First National Bank,
Broadway, New York.
CHARLES HOWARD'S SONS.

Or

Sighted, January 25, 19...
Accepted.
CHARLES HOWARD'S SONS.

Accepted.
ROBERT HUDSON.

Or

Accepted.
Payable at Barclays Bank,
36 Briggate, Leeds.
ROBERT HUDSON.

Or

Accepted.
per pro. ROBERT HUDSON,
JOHN WILKES, AGENT.

Or

Accepted.
Payable at Barclays Bank,
36 Briggate, Leeds.
per pro. ROBERT HUDSON.
JOHN WILKES, *Agent.*

The place where the bill is made payable is called the *domicile* of the bill. In example 4, it is necessary to state the day on ~~which the~~ bill was sighted, *i.e.* the day on which it was presented for acceptance, in order to fix the day of payment, which in this instance is the sixtieth day from January 25. There are no days of grace in the United States.

General and Qualified Acceptances.—The forms of acceptance shown above are *general* acceptances because they assent to the drawers' orders without qualification. But by S. 19 an acceptance may be *qualified.* The acceptance may make payment *conditional, e.g.* it may make payment contingent upon the surrender of shipping documents; or it may be a *partial* acceptance, as, *e.g.* where a bill for £100 is accepted payable for £50; or it may be qualified in time, as, *e.g.* where a bill drawn payable sixty days after sight is accepted payable ninety days after sight; or it may be the acceptance of one or more of the drawees of a bill but not of all; or it may confine payment to a particular specified place. But an acceptance to pay at a particular place is not qualified unless it expressly states that payment is to be made at that place only.

By S. 44, the holder of a bill is not bound to take a qualified acceptance and may treat the bill as dishonoured by non-acceptance if he cannot obtain a general acceptance. The holder of a bill who has taken a qualified acceptance should give immediate notice to the drawer and indorsers of the bill, and if these do not within a reasonable time express their dissent to the holder they are deemed to have assented thereto. If the drawer or any indorser dissents, he is discharged from liability on the bill. Where the acceptance is partial, *i.e.* for part only of the amount, notice of the fact given by the holder to the drawer or any indorser operates to prevent his discharge from the bill.

Rules as to Presentment.—Presentment for acceptance must be made by or on behalf of the holder of the bill to the drawer or to some one authorised to accept or refuse acceptance on his behalf at a reasonable hour on a business day and before the bill is overdue. Where a bill is addressed to two or more drawees, who are not partners, presentment must be made to them all, unless one has authority to accept for all, then presentment may be made to him only. Where the drawee is dead, presentment may be made to his personal representative; where he is bankrupt, to him or his trustee. Where authorised by agreement or usage, presentment through the post is sufficient (S. 41 [1]).

Presentment according to the above rules is excused, and the bill may be treated as dishonoured by non-acceptance, where the drawee is dead or bankrupt, or is a fictitious person, or a person not having capacity to contract by bill [*e.g.* an infant], or where, after the exercise of reasonable diligence, presentment cannot be effected, or where, although the presentment has been irregular, acceptance has been refused upon some other ground (S. 41 [2]).

It is customary to allow the bill to remain with the drawee for a period of twenty-four hours, after which time he must deliver up the bill to the presenter on demand, or return it through the post if it has been presented for acceptance through the post. If the drawee declines to accept, he usually states his reason when delivering up the bill, *e.g.* "No advice," "Not in order," etc.

When a bill payable after sight is negotiated, the holder must either present it for acceptance or negotiate it within a reasonable time. If he does not do so, the drawer and all indorsers prior to the holder are discharged. What is reasonable time is determined by the nature of the bill, the usage of trade with respect to similar bills, and the facts of the particular case (S. 40).

When a bill is duly presented for acceptance and is not accepted within the customary time, the person presenting it must treat it as dishonoured by non-acceptance. If he do not, the holder shall lose his right of recourse against the drawer and indorsers (S. 42). When a bill is dishonoured by non-acceptance, an immediate right of recourse against the drawer and indorsers accrues to the holder, and no presentment for payment is necessary (S. 43 [2]). *See* Dishonour of Bill, p. 774.

Presentment for Payment.—A bill must be duly presented for payment, for if not the drawer and indorser are discharged. A bill not payable on demand must be presented on the day it falls due. A bill payable on demand must be presented within a reasonable time after issue to make the drawer liable, and within a reasonable time after indorsement to make the indorser liable. "Reasonable time" means reasonable having regard to the nature of the bill, trade usage with regard to similar bills, and the facts of the particular case.

Presentment for payment must be made by the holder, or a person authorised by him to receive payment, at a reasonable hour, on a business day, at the proper place, to the person designated by the bill as payer, or to some person authorised by him to pay or refuse payment.

"Proper place" means the place of payment specified in the bill, *e.g.* the bank where a bill is domiciled; or, where no place is specified, the address of the drawee or acceptor given in the bill; or, where no place of payment is specified and no address given, the drawee's or acceptor's place of business if known, and if not, his ordinary residence if known; or in any other case at whatever place the drawee or acceptor can be found, or his last known place of business or residence.

Where a bill is presented at the proper place, and after the exercise of reasonable diligence no person authorised to pay or refuse payment can be found, no further presentment to the drawee or acceptor is required.

Where a bill is drawn upon or accepted by two or more persons who are not partners, and no place of payment is specified, presentment must be made to them all. Where the drawee or acceptor is dead, and no place of payment is specified, presentment must be made to a personal representative if such there be, and with the exercise of reasonable diligence he can be found.

Where authorised by agreement or usage presentment through the post office is sufficient (S. 45).

Delay in presentment for payment is excused when the delay is caused by circumstances beyond the holder's control, and not imputable to his default, misconduct, or negligence. But when the cause of delay ceases to operate presentment must be made with reasonable diligence.

Presentment for payment is dispensed with where presentment as required by the Act cannot be effected; where the drawee is a fictitious person; as regards the drawer, where the drawee or acceptor is not bound, as between himself and the drawer, to accept or pay the bill, and the drawer has no reason to believe that the bill would be paid if presented; as regards an indorser, where the bill was made for his accommodation, and he has no reason to expect that the bill would be paid; by waiver of presentment, express or implied (S. 46).

Days of Grace.—Where a bill is drawn payable after date or after sight, it is the law in this country that, unless the bill by its terms provides otherwise, the due date of payment is three days after the determinable date fixed by the bill.

By S. 14, where a bill is not payable on demand, the day on which it falls due is determined as follows:—

> Three days, called days of grace, are, in every case where the bill does not otherwise provide [*e.g.* where the bill is payable on a date *fixed*, or is made payable without days of grace], added to the time of payment as fixed by the bill, and the bill is due and payable on the last day of grace.

But inasmuch as bills and cheques are payable only on business days (and within banking hours), S. 14 also provides as follows—

(a) When the last day of grace falls on Sunday, Christmas Day, Good Friday, or a day appointed by Royal Proclamation as a public fast or thanksgiving day, the bill is due and payable on the preceding business day.

(b) When the last day of grace is a bank holiday (other than Christmas Day or Good Friday), under the *Bank Holidays Act*, 1871, and Acts amending or extending it, or when the last day of grace is a Sunday, and the second day of grace is a bank holiday, the bill is due and payable on the succeeding business day.

Where a bill is payable at a fixed period after date or sight or the happening of a specified event, the time of payment is determined by excluding the day from which the time is to begin to run, and by including the day of payment.

Where a bill is payable as a fixed period after sight, the time begins to run from the date of acceptance, or if the bill is noted or protested for non-acceptance or for non-delivery from the date of noting or protesting.

The term "month" in a bill means calendar month. (A bill dated, for example, April 30 and drawn payable one month after date becomes due for payment on June 2, and not on June 3. No account is taken of "lacking" days. Thus a bill dated January 31 payable two months after date is due for payment on April 3.)

Dishonour of Bill.—A bill payable on demand can be dishonoured in one way only, viz. by non-payment. A bill payable after sight or date may be dishonoured in one of two ways, viz. (*a*) by non-acceptance, (*b*) non-payment. When a bill is dishonoured by non-acceptance, an immediate right of recourse against the drawer and indorsers accrues to the holder, and no presentment for payment is necessary (S. 43). And that right of recourse becomes a right of action against all prior parties to the bill as soon as the holder has given due notice of dishonour to those parties, and, where necessary, has had the bill protested. Similarly, where a bill is dishonoured by non-payment, the holder has an immediate right of recourse against each party to the bill, which crystallises into a right of action against them as soon as he has given them due notice of dishonour, and, where required, has had the bill protested. But it is not necessary in order to take proceedings against the drawee or acceptor of a dishonoured bill to protest the bill or give him notice of dishonour (S. 52 (3)). The drawer of a bill and any indorser thereof to whom due notice of dishonour is not given is discharged from liability on the bill (S. 48).

Notice of Dishonour.—This matter is dealt with in Sections 48 to 50 of the Act.

No special form of notice is laid down by the Act, but the terms of the notice must sufficiently identify the bill. Notice may be given orally or in writing. If written, the notice need not be signed. If the notice is duly addressed and sent through the post, notice is deemed to have been given, notwithstanding any miscarriage by the Post Office.

Usually, notice takes the form of a letter from the holder or his agent in that behalf, to the party he seeks to charge, or to that party's agent, intimating the fact of dishonour either by non-acceptance or non-payment, giving particulars of the bill and the parties thereto, and requesting immediate payment of the amount of the bill plus any expenses incurred. As between collecting banker and customer, the return to the latter of a dishonoured bill is in point of form deemed sufficient notice of dishonour.

Notice must be given by or on behalf of the holder, or by or on behalf of an indorser who is himself liable on the bill at the time notice is given. So, if any party to a dishonoured bill be discharged for want of notice, or for want of notice within reasonable time, that party cannot give effectual notice of dishonour. Notice may be given as soon as the bill is dishonoured, and must be given within a reasonable time thereafter. In the absence of special circumstances, reasonable time means: (*a*) where the person giving and the person to receive notice reside in the same town, the notice is sent off in time to reach the latter the day after dishonour; (*b*) where they reside in different places, the notice is sent off the day after dishonour, if there be a post at a convenient hour on that day, and if not by the next post thereafter.

Where a bill is in the hands of an agent, as, *e.g.* where one banker employs another banker as agent for collection, both agent and principal have each the same time in which to give notice of dishonour, and any party to a bill receiving due notice has also the same time for giving notice to prior parties to the bill.

Where the drawer or indorser is dead, and the party giving notice knows it, notice must be given to a personal representative if such there be, and with the exercise of reasonable diligence he can be found. Where the drawer or indorser is bankrupt notice may be given to the bankrupt or to the trustee. Where there are two or more drawers or indorsers who are not partners, notice must be given to each, unless one of them has authority to receive notice for the others.

Delay in giving notice is excused where the delay is caused by circumstances beyond the control of the party giving notice, and not imputable to his default, misconduct, or negligence. When the cause of delay ceases to operate the notice must be given with reasonable diligence.

Notice is dispensed with when, after the exercise of reasonable diligence, notice cannot be given, or fails to reach the person sought to be charged; or, when notice is expressly or impliedly waived; as regards the drawer, where drawer and drawee are the same person, or where the drawee is a fictitious person, or a person incapable of contracting by bill, or where the drawer is the person to whom the bill is presented for payment, or where the drawee or acceptor as between himself and the drawer is under no obligation to pay the bill, or where the drawer has countermanded payment. As regards the indorser, where the drawee is a fictitious person, or a person not having capacity to contract, and the indorser was aware of the fact at the time he indorsed the bill; or where the indorser is the person to whom the bill is presented for payment; or where the bill was accepted or made for his accommodation.

Noting and Protesting.—Where an *inland* bill is dishonoured it *may* be noted and protested, but, except where an inland dishonoured bill is to be accepted or to be paid for honour, noting and protesting are not legally necessary. But a dishonoured *foreign bill*, whether it be dishonoured by non-acceptance or by non-payment, must be protested, otherwise the drawer and indorsers are discharged. And a foreign bill that has been protested for non-acceptance, and afterwards been presented unsuccessfully for payment, may again be protested for non-payment. It is necessary that the fact of dishonour should, in the case of foreign bills, be indisputably established, and a notary's certificate of dishonour is everywhere accepted as conclusive proof of the fact. The dishonoured bill is handed, immediately on dishonour, to a notary public, and that functionary must re-present the bill to the drawee or acceptor not later than the next business day following the day of dishonour (*Bills of Exchange (Time of Noting) Act*, 1917).

Noting consists of a memorandum written on the bill consisting of the date, the charges for noting, a reference to the Notary's register containing particulars of dishonoured bills, and his own initials. The Notary also attaches to the bill a slip on which he writes the reason for dishonour, if any is given to him. Protest is an extension of the act of noting. It consists of a formal certificate given by the Notary, containing a copy of the bill, specifying the name and address of the person to whom he presented it, and of the person on whose behalf, and the date on which he presented it, and the answer given to him, or else the fact that the drawee or acceptor could not be found. The formal protest need not be made at the time of noting, but may be extended at any time, as of the date of noting, prior to bringing an action on the bill. Protest is dispensed with in circumstances which would dispense with notice of dishonour, and delay in noting or protesting is excused in circumstances that would excuse delay in giving notice of dishonour (S. 51).

Acceptance and Payment for Honour.—By S. 15, the drawer or any indorser of a bill may insert therein the name of a person to whom the holder may resort should the bill be dishonoured by non-acceptance or non-payment. Such a person is called the *referee in case of need* (or more briefly the *case of need*). The holder may or may not resort to the case of need at his option. The mention of a case of need in a bill does not make him a party to the bill, but he may become a party to it, if the holder, having first protested the bill for non-acceptance or non-payment, resorts to him, and he accepts, or pays, the bill for honour.

By S. 65, where a bill has been protested for dishonour by non-acceptance, and it is not overdue, any person not already liable on the bill may with the holder's consent intervene and accept the bill *supra* protest for the honour of any party liable thereon, or for the honour of the person for whose account the bill is drawn. Such an acceptance is known as an *acceptance for honour supra protest*, and to be valid it must be written on the bill and indicate that it is an acceptance for honour, and be signed by the acceptor for honour. Where the acceptance for honour does not state for whose honour it is made, it is deemed to be an acceptance for the honour of the drawer. The maturity of a bill payable after sight and accepted for honour is calculated from the date of noting for non-acceptance.

By S. 66, the acceptor for honour engages that he will, on due presentment, pay the bill if it is not paid by the drawee, provided that the bill is protested and due notice of these facts is given to him. He is liable to the holder and to all parties to the bill subsequent to the party for whose honour he accepts the bill.

By S. 68, where a bill has been protested for non-payment, any person may intervene and pay it *supra* protest for the honour of any party liable thereon, or for the honour of the person for whose account the bill is drawn. Such a payment is known as *payment for honour supra protest*. Where a bill has been paid for honour, all parties subsequent to the party for whose honour the bill is paid are discharged. The payer for honour is subrogated to the holder, *i.e.* he, so to speak, steps into the holder's shoes, and has all the holder's rights against, and is subject to all the holder's duties to, the person for whose honour he pays, and all parties liable on the bill to that person.

It is to be noted that an acceptance for honour can be made only by consent of the holder, and the acceptor for honour must not prior to his acceptance be liable on the bill, and the bill must not be overdue. If the holder consents to a person accepting for honour, he loses his immediate right of recourse against prior parties to the bill. It is therefore but just that the holder should have the right to say whether he will accept a case of need, or an intervener for honour, and await the result of presentment for payment to the case of need or the intervener rather than take action at once on the bill dishonoured by non-acceptance. But the consent of the holder is not necessary to the intervention of a payer of the bill for honour, and the intervener may already be liable on the bill. Further, it is clear that the bill must be overdue before he intervenes. A holder cannot look for more than payment of the bill according to its tenor, and, if he refuses payment *supra* protest, he loses his right of recourse against any party to the bill who would have been discharged by such payment.

It is the usual practice for acceptances for honour to be attested by a notary, and, by S. 68 (3), a payment for honour must be so attested in order to operate as such.

Amount Recoverable on Dishonoured Bill.—By S. 57, where a bill is dishonoured, the measure of damages, which shall be deemed to be liquidated damages (*i.e.* agreed damages, the amount of which cannot be questioned) shall be: the amount of the bill; interest thereon from the time of presentment for payment, if the bill is payable on demand, and from the maturity of the bill in any other case (usually at 5% p.a.); the expenses of noting, and the expenses of protest if protest is necessary and has been extended. Interests may be payable by the terms of the bill itself. This applies to bills dishonoured in this country. Where a person is liable on a bill and it is dishonoured in a foreign country wherein it is payable, the measure of damages is the amount of the *re-exchange* with interest thereon until the time of payment, plus expenses. Re-exchange means the amount in sterling that would have been required to produce in the place of payment at the time of dishonour the exact amount of foreign currency for which the bill is drawn, or expressed to be payable.

Liability of Parties to a Bill.—By S. 54, the acceptor is the person primarily liable on a bill, for he it is who contracts to pay it according to the tenor of his acceptance. By accepting, he acknowledges the existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the bill; and, if the bill is drawn to the drawer's order, the capacity of the drawer to indorse, but not the genuineness or validity of his indorsement; and, if the bill is payable to the order of a third person, the existence of the payee and his then capacity to indorse, but not the genuineness or validity of his indorsement. The acceptor cannot deny any of these things to a holder in due course of a bill; and he can seldom have any ground of defence against an action for the amount of the bill brought against him by such a holder, except in the case of forgery.

As to forgery, S. 24 says that a forged or unauthorised signature on a bill is wholly inoperative, and no right to retain a bill or to give a discharge therefor or to enforce payment thereof against any party thereto can be acquired through or under that signature, unless the party against whom it is sought to retain or enforce payment of the bill is precluded from setting up the forgery or want of authority (*e.g.* where the party sought to be charged has by his conduct led the other party to believe the forged signature to be genuine, or has not repudiated the forgery as soon as it was brought to his notice).

By S. 55 (1), the drawer of a bill engages that on due presentment it shall be accepted, and paid according to its tenor, and that if it is dishonoured he will compensate the holder or any indorser who is compelled to pay it, provided that the requisite proceedings on dishonour be duly taken. He cannot deny to a holder in due course the existence of the payee and his then capacity to indorse.

By S. 55 (2), the liability of an indorser is similar to that of the drawer, but whereas the drawer is liable to the holder or any indorser who is compelled to pay the bill, an indorser is liable only to the holder and those indorsers subsequent to himself, provided that the requisite proceedings on dishonour be duly taken. An indorser cannot deny to a holder in due course the genuineness and regularity in all respects of the drawer's signature, and all previous indorsements, and to his immediate or a subsequent indorsee that the bill was at the time of his indorsement a valid and subsisting bill, and that he had then a good title thereto.

Where there are two or more indorsements on a bill, each indorsement is deemed to have been made in the order in which it appears on the bill, until the contrary is proved (S. 32 [5]).

Where a bill is dishonoured by non-acceptance, the drawee is not liable on the bill, and the drawer's remedy against the drawee is to sue him not on the bill itself, to which he is not a party, but for the consideration in respect of which the bill was drawn. But the holder of such a bill may sue all parties to the bill, provided he has given, or they have in fact received, due notice of dishonour. Where an accepted bill is dishonoured by non-payment, the acceptor is the person primarily and ultimately liable on the bill, and the liability will be forced back from the holder, through each indorser in the order in which he indorsed, to the drawer, and by him upon the acceptor. But provided that the holder has given due notice of dishonour to each party to the bill, or each party (other than the acceptor) has in fact received due notice through other parties to the bill, the holder can, if he fails to secure payment from his own indorsee, proceed against any other indorsee or against the drawer, for each party to the bill is severally liable upon it. Usually, however, the holder looks to his own immediate indorsee for payment, and is paid by him, and the indorsee who pays the holder looks to his own immediate indorsee and is paid by him, and so the liability is forced back upon the drawer, who, having paid, is left with his legal remedy against the acceptor.

Holder and Holder in Due Course.—Both these terms have been used above, and it is necessary to understand their precise significance. By S. 2, the holder of a bill is the payee or indorsee of a bill or note who is in possession of it, or the bearer thereof. A mere holder may, however, be infected with notice of some defect in the title to the instrument of the person who negotiated it to him, and for that reason be unable to enforce payment of it. Opposed to a bare holder is a holder in due course. By S. 29, a holder in due course of a bill is a holder who has taken a bill, complete and regular on the face of it, under the following conditions, viz. that he became the holder of it before it was overdue, and without notice that it had been previously dishonoured, if such was the fact; that he took the bill in good faith and for value, and that at the time the bill was negotiated to him he had no notice of any defect in the title of the person who negotiated it.

Value is defined in S. 27 as follows:—

> Valuable consideration for a bill may be constituted by any consideration sufficient to support a simple contract all contracts by bill are simple contracts); an antecedent debt or liability. Where value has at any time been given for a bill, the holder is deemed to be a holder for value as regards the acceptor and all parties to the bill who became parties prior to such time. Where the holder of a bill has a lien on it, arising either from contract or by implication of law, he is deemed to be holder for value to the extent of the sum for which he has a lien.

The difference in the position of a holder and a holder in due course may be simply explained as follows: A draws a bill upon B for the price of goods sold to B, which B accepts. A then negotiates the bill to C. It turns out that the goods are defective and rejected by B, who dishonours the bill on presentment for payment. A cannot recover the amount of the bill from B, because the consideration for the bill has failed. But if C has given value for the bill to A, and has taken it in good faith, knowing nothing of the facts, and before it was overdue then C is holder in due course of the bill and can recover the amount either from B or from A. If, on the other hand, C was aware that the consideration for the bill had failed at the time he took it, he would be a holder of the bill but not a holder in due course, and would have no better right to enforce payment against B than A had.

Again, suppose D to be the holder of an overdue bill, and he negotiates the bill to E. Then since E takes the bill when it is overdue, he cannot be a holder in due course of the bill. So if D has a right to enforce payment E has as good a right, but if D has no right E has no right.

The date shows whether a bill not payable on demand is overdue or not. A bill payable on demand is deemed to be overdue when it has been in circulation for an unreasonable time. What is an unreasonable time is a question of fact (S. 36 (3)).

No one can become a holder in due course of a bill who takes it with notice that it has been dishonoured, but if a person *bona fide* takes such a bill without notice of the dishonour he is a holder in due course (S. 36 (5)).

No one can become a holder in due course of a bill if it is vitiated by a prior forgery, or if the bill is void under any Statute. But if a person takes a bill drawn payable to bearer, or which has become payable to bearer by a genuine indorsement in blank, from a person who has found or stolen such a bill, and who is therefore a wrongful holder, and he does so in circumstances that satisfy the definition of a holder in due course contained in S. 29, then he is such a holder, and can sue all parties to the bill, for he is not affected by the fact that his transferor had no title to the bill.

Negotiation of Bill.—The negotiation of bills is governed by Sections 31 to 37 of the Act.

A bill is negotiated when it is transferred from one person to another in such a manner as to constitute the transferee the holder of the bill. A bill payable to bearer is negotiated by delivery. A bill payable to order is negotiated by the indorsement of the holder completed by delivery.

Indorsement consists of the holder's signature written on the back of the bill, or on an allonge, or on a "copy" of a bill issued or negotiated in a country where "copies" are recognised. (An allonge is a piece of paper gummed to the bill in order to accommodate further indorsements when the back of the bill is already full).

Where in a bill payable to order, the payee or indorsee is wrongly designated or his name is misspelt, he may indorse the bill as therein described, adding, if he thinks fit, his proper signature.

If a bill be made payable to "A. B." or to "A. B. or order," or "to the order of A. B." and A. B. indorses the bill without specifying the indorsee, the indorsement is an *indorsement in blank*, and the bill is then payable to bearer and can be negotiated thereafter by delivery alone.

If A. B., when indorsing the bill, specifies the indorsee, *e.g.* "Pay C. D. or order, A. B." the bill is still an order bill, and C. D. must negotiate it by indorsement and delivery. Such an indorsement is termed a *special indorsement*.

When a bill has been indorsed in blank, any holder may convert the blank indorsement into a special indorsement by writing above the indorser's signature a direction to pay the bill to or to the order of himself or some other person.

In the commercial practice of this country it is the invariable rule to negotiate a bill by indorsement and deliver, since, naturally, in all cases, the transferee of a bill desires his transferor to be a party liable on the bill.

An indorsement must be an indorsement of the entire bill, it cannot purport to transfer a part only of the amount to the transferee; and it cannot purport to transfer the bill to two or more indorsees severally; and it cannot be a conditional indorsement, for, if it is, the condition can be disregarded. But an indorsement may be a *restrictive indorsement* prohibiting further negotiation of the bill, as, *e.g.* where the indorsement takes the following forms: "Pay A. B. only"; or "Pay A. B. for the account of C. D."; or "Pay A. B. for collection."

Where a bill is payable to the order of two or more payees or indorsees who are not partners, all must indorse, unless one has authority to indorse for the other or others.

Principal and Agent.—No person is liable as a party to a bill who has not signed it as such, but if a person signs a bill in a trade or assumed name he is just as liable as if he had signed his own name. A partner signing the name of his firm makes the firm and each member of the firm liable on the bill, provided the partner signing was acting within the scope of his authority (S. 23).

Generally speaking, whatever contract a person may make in his own name he may also make through his duly appointed agent. An agent who signs his own name only to a bill makes himself personally liable on the bill but not his principal, and he is also personally liable though he adds merely descriptive words to his signature. For example, an agent who, purporting to accept a bill on behalf of his principal, signs in the form "A B., agent" is alone liable on the bill. To negative personal liability, the agent's signature must clearly show that he is signing in a representative capacity, *e.g.* thus: "per pro." (or "for and behalf of") "Jonathan Edwards, James Brown"; or "For and behalf of The Alliance Trading Company, Ltd., Howard Jenkins, Managing Director." A signature by procuration operates as notice that the agent has but a limited authority to sign, and puts the person taking an instrument so signed on enquiry as to the scope of the agent's authority, for if the agent is exceeding his authority in so signing, the principal is not bound by the signature (SS. 25 and 26). The agent, however, is liable in damages for having pretended to an authority that he did not possess.

By S. 31, where any person (*e.g.* an agent) is under obligation to indorse a bill in a representative capacity, he may indorse the bill in such terms as to negative personal liability. He does this by adding to his signature the words "Sans Recours," or "Without recourse to me."

Discharge of Bill.—A bill is discharged when all rights of action on the bill are extinguished. But although the bill itself be discharged, there may still exist rights of action arising out of the transaction in respect of which the bill was drawn. For example, if a person accepts a bill for the accommodation of a person not liable on the bill, and he pays it, the bill is discharged, but the acceptor still has a right of action against the person for whose accommodation he accepted the bill.

A bill may be discharged in five ways:

(1) By payment in due course. Payment in due course means payment made at or after the maturity of the bill to the holder thereof in good faith, and without notice that his title to the bill is defective. Payment by the drawer or an indorser does not discharge the bill, for both still have rights of action on the bill (S. 59 [1]).

(2) When the acceptor becomes the holder of it at or after its maturity in his own right, *i.e.* when in the course of its negotiation it is negotiated back to the acceptor. By such *circuity of action* the right of the acceptor as holder of the bill cancels his liability upon it as acceptor (S. 61).

(3) When the holder of a bill at or after its maturity absolutely and unconditionally renounces his rights against the acceptor. The renunciation must be in writing, unless the bill is delivered up to the acceptor (S. 62 [1]).

(4) When a bill is intentionally cancelled by the holder or his agent, and the cancellation is apparent. Any party liable on a bill may be discharged by the holder or his agent intentionally cancelling that party's signature. Such cancellation serves to discharge all indorsers subsequent to the party discharged, but the bill is undischarged as regards other parties to the bill (S. 63).

(5) When a bill or acceptance is materially altered without the assent of all parties liable on the bill, the bill is avoided except as against a party who has himself made, authorised, or assented to the alteration, and subsequent indorsers. The following alterations are material, viz. alterations of date, sum payable, time of payment, place of payment, and where a bill has been accepted generally, the addition of a place of payment without the acceptor's assent (S. 64).

An immaterial alteration has no effect, and where a bill has been materially altered and the alteration is not apparent, a holder in due course has the same rights under the bill as he would have if it had not been altered (S. 64).

Accommodation Parties and Bills.—A person who signs a bill as drawer, acceptor, or indorser without receiving value for so doing, and for the sole purpose of enabling the person to whom he lends his name to raise money is termed an *accommodation party*. The person accommodated is bound to provide funds to discharge the bill at maturity, but, whether he does so or not, the person accommodating may be compelled to pay the bill to any holder of the bill for value. If a person takes an accommodation bill for value, it is immaterial whether, at the time of taking it, he knew that the party from whom he took it was an accommodation party.

An *accommodation bill* is a bill which is accepted, without the acceptor receiving value for so doing, in order to accommodate some other person who may or may not be liable on the bill. Such an acceptor, although primarily liable thereon, is not the principal debtor on the bill, but a surety for the party whom he accommodates, and that party is bound to provide the acceptor with funds to meet the bill at maturity (S. 28).

Bill in a Set.—Inland bills are not drawn in a set, but foreign bills usually are—Continental bills in a set of two, bills on more remote countries in a set of three. Bankers' drafts are commonly drawn in sets of two marked "Original" and "Duplicate." Each bill of the set is numbered and contains a reference to the other part or parts. The examples on p. 768 illustrate a bill in a set. Each part is worded alike, except that the second part would read "Pay this Second of Exchange (first and third of the same tenor and date unpaid)," and the third part "Pay this Third of Exchange (first and second of the same tenor and date unpaid)." The first of Exchange is sent forward by one mail, and the second by a subsequent mail, hence the latter is called the *secunda via*.

One part only of such a bill is stamped, since all three (or two) parts constitute but one bill. One part only, usually the first that comes to hand, is presented for acceptance and accepted. If more than one part were accepted, the acceptor would be liable on each accepted part as separate bills to different holders in due course of such parts. Further, the holder of the bill, if he indorsed more than one part, would be liable to a holder in due course of each part that he had indorsed. And if the acceptor paid the bill, without requiring the part that he had accepted to be delivered up to him, he would be liable to a holder in due course of the part that he had accepted. With these exceptions payment of one part discharges the whole bill (S. 71).

II. CHEQUES.

A cheque is a specialised bill of exchange. It is legally defined in S. 73 as "a bill of exchange drawn on a banker payable on demand." The definition of a bill of exchange, set out on p. 764, applies equally to a cheque, except that a cheque must always be payable on demand, and always be drawn upon a banker. The law applicable to bills of exchange payable on demand applies generally to cheques, with such exceptions as are set out in Pt. III of the Act of 1882, and briefly noted below.

As with other bills of exchange, so with cheques. To every cheque there are primarily three parties, viz. drawer, drawee (a banker), and payee. But frequently the drawer and payee are the same person, because the drawer directs payment to himself.

A cheque, being payable on demand, is not presented to the drawee banker for acceptance but only for payment, and the banker is bound to pay the cheque only so long as he holds funds of the drawer sufficient to pay it, or within the limits of any overdraft the banker may have agreed to allow the drawer. If a banker wrongfully refuses to pay a customer's cheque, he is liable to an action for damages for injury to the customer's credit.

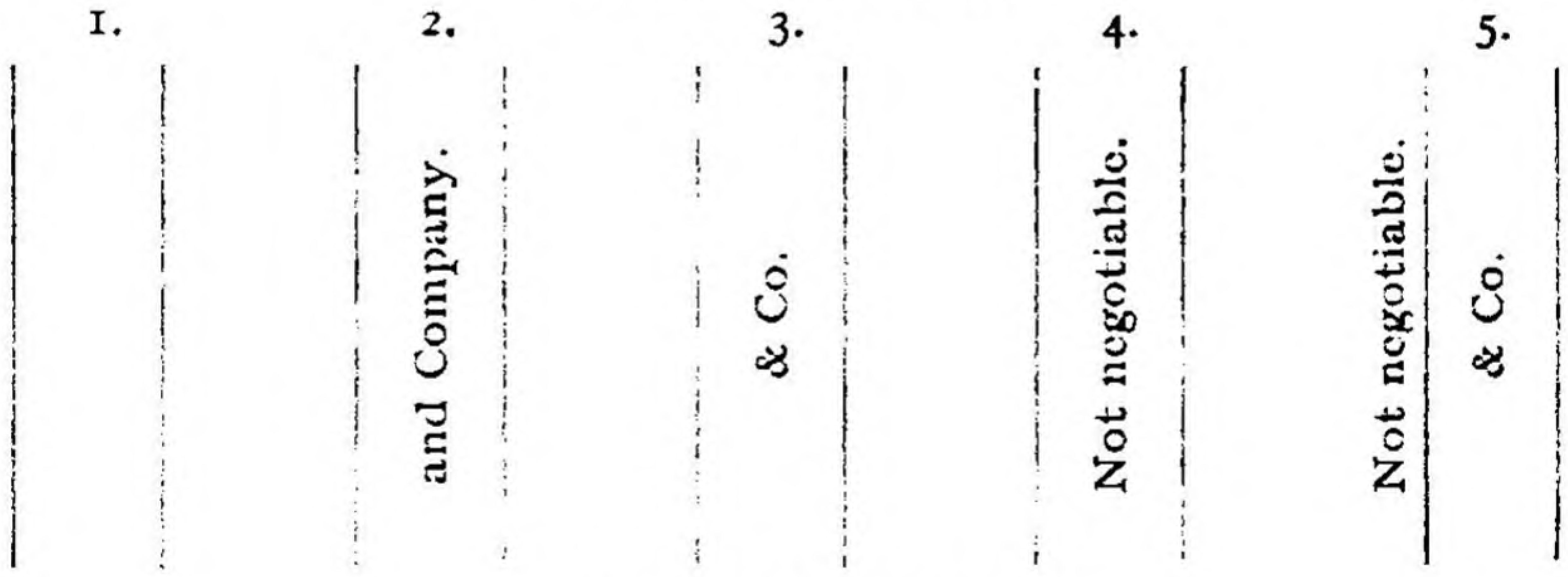
Dishonour of Cheque.—When a banker dishonours a cheque, the drawer is entitled to notice of dishonour, but notice is dispensed with when: (*a*) the drawer has no funds or insufficient funds to his credit, and has therefore no reason to expect that the cheque will be paid; or (*b*) when the customer has countermanded payment; or (*c*) when the banker has had notice of the drawer's death or of an act of bankruptcy committed by him, or of an assignment by the drawer of his available balance at the bank, or of a garnishee order restraining the drawer from operating upon the account, or where the banker has knowledge that a breach of trust is intended by the drawer in drawing the cheque, or, in the case of a company, of its winding-up. In other circumstances, for example, where a cheque is irregularly drawn, the banker should give due notice to the customer.

When dishonouring cheques, the banker marks upon them the reason for dishonour. If the reason be insufficiency of funds, the best answer is R/D = refer to drawer, although N/S = not sufficient funds, is also used when the circumstances justify this marking. Other markings, where appropriate, are "Words and figures differ," "Indorsement irregular," "Effects not yet cleared," "Second signature required," etc. Answers must be written *in full* on the instrument.

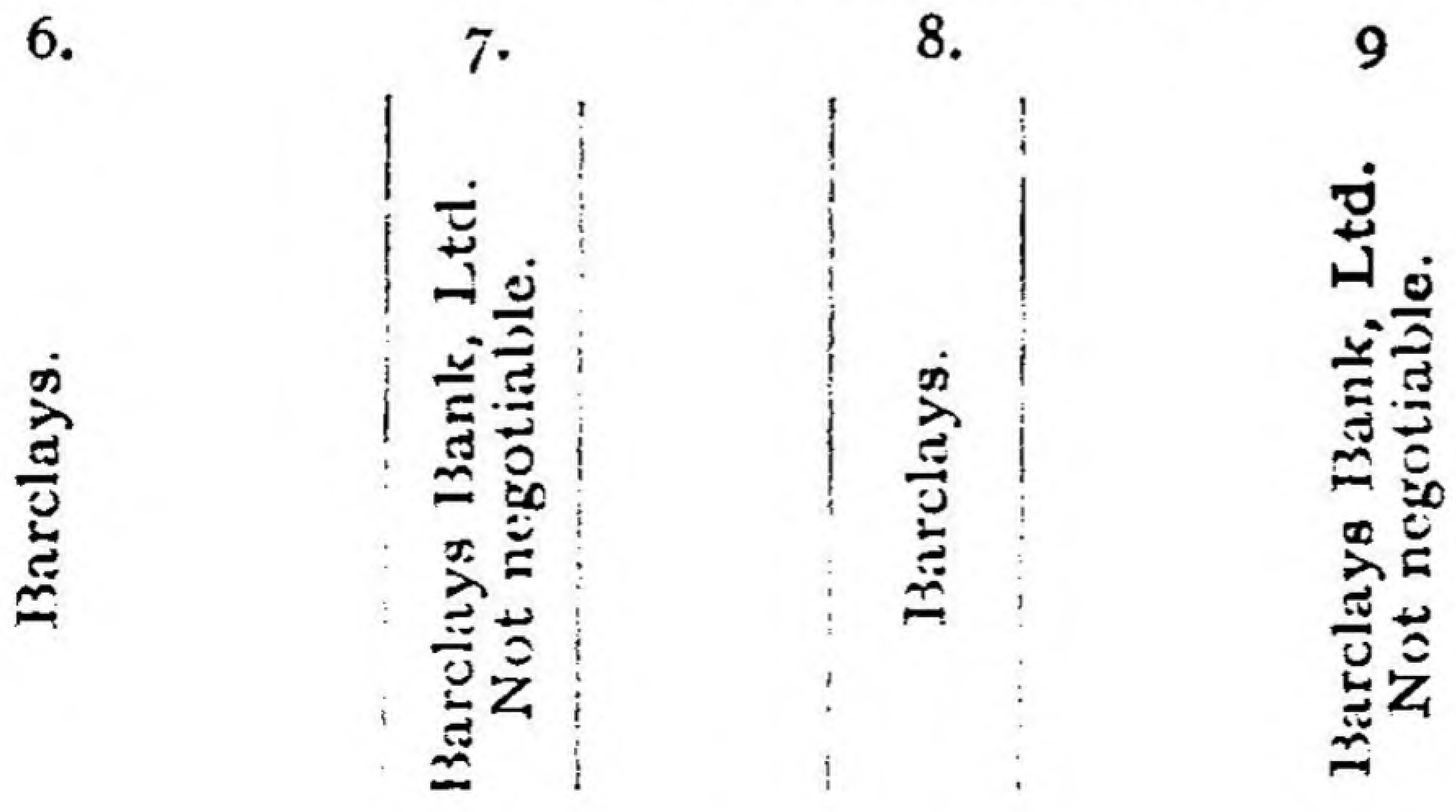
Crossed Cheques.—A cheque may be crossed generally or specially. A *general crossing* consists of the words "and Company" or any abbreviation thereof, between two parallel transverse lines, either with or without the words "not negotiable"; or two parallel lines simply, either with or without the words "not negotiable." A *special indorsement* consists of an addition across the face of the cheque of the name of a banker, either with or without the words "not negotiable" (S. 76).

The following illustrate a few forms of crossing:—

GENERAL CROSSINGS.



SPECIAL CROSSINGS.



By S. 77, a cheque may be crossed generally or specially by the drawer. Where a cheque is uncrossed, the holder may cross it generally or specially. Where a cheque is crossed generally or specially, the holder may add the words "not negotiable." Where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another banker for collection. Where an uncrossed cheque, or a cheque crossed generally, is sent to a banker for collection, he may cross it specially to himself. A crossing authorised by the Act is a material part of the cheque; it shall not be lawful for any person to obliterate or, except as authorised by the Act, to add to or alter the crossing.

Non-Statutory Additions to Crossing.—The words "Payee's Account," "Payee's Account only," "Account of A. B.," "Under £10," and variants thereof, are frequently found on cheques in close proximity to the crossing. These have no statutory significance. The first and third additions are a direction to the collecting banker to collect the cheque for, and to place the proceeds to the credit of, the named payee, and if he were to place the proceeds to the credit of any other account, he would be guilty of negligence. The fourth addition is a protective device to prevent fraudulent raising of the amount of the cheque. The second addition places the paying banker in some difficulty and is therefore objectionable. He would be justified in refusing payment of a cheque with this marking if it were an open cheque presented across the counter for payment, since he is not in a position to identify the payee, and he would also be justified in refusing payment, if the cheque bearing these words were a crossed cheque that bore evidence of having passed through the hands of a person other than the named payee.

The holder of a cheque payable to bearer, or the holder of an uncrossed cheque payable to order, can himself obtain payment of the cheque across the counter by presenting it to the drawee banker, he having, in the second case, first indorsed the cheque. The holder of a cheque crossed generally cannot obtain payment except by having it presented to the drawer banker through another banker. The holder of a cheque crossed specially can obtain payment only through the banker named in the crossing. A banker may pay a cheque crossed generally only to another banker, and a cheque crossed specially only to the named banker. If he pays a cheque in a manner inconsistent with the crossing, and loss ensues, he cannot debit the drawer's account, and he is liable to the true owner of the cheque, *i.e.* the person who is legally entitled to the cheque and its proceeds. A banker is in general accountable only to his customer; his liability to the true owner in the circumstances mentioned is an exception to this rule.

Indorsement of Cheques.—The indorsement of bills and cheques must conform to the designation of the indorser as indicated either on the face of the bill or cheque, or in a special indorsement thereof. By S. 32 (4) where the payee or indorsee is wrongly designated, or his name is misspelt, he may indorse the bill as therein described, adding, if he think fit his proper signature. The correctness or incorrectness of an indorsement is, in the main, determined by banking and mercantile custom. No rules can be laid down that will meet all cases. The experience of a practical banker is the best guide, and the student is therefore referred to H. P. Sheldon's *Practice and Law of Banking*, 3rd Edition, pp. 17–49, where the subject is exhaustively treated.

Not Negotiable Crossing.—By S. 81, a person who takes a crossed cheque which bears on it the words "not negotiable" shall not have and shall not be capable of giving a better title to the cheque than that which the person from whom he took it had. The words "not negotiable" have no significance apart from one of the recognised crossings, and, when added to such a crossing, they in no way impair the transferability of the cheque. What they do is to destroy its negotiability. The distinctive feature of negotiability is that a holder of a negotiable instrument, who has taken it in good faith, and for value, and without notice of any defect in the title of the person from whom he took it, in all cases, except when the instrument bears a forged signature, acquires an indefeasible title to the instrument. But, if he takes a cheque bearing a not negotiable crossing, he has no better title to the instrument than his transferor has. So, if A draws a cheque in favour of B and places upon it a not negotiable crossing, and B indorses the cheque, and the cheque is subsequently stolen by C, who persuades D to cash the cheque, then, notwithstanding that D may have taken the cheque in good faith, and for value, without knowledge that C was a wrongful holder, he has no better right to enforce payment of the cheque than C has, and that is no right at all. Had the cheque not borne a not negotiable crossing, D, in the same circumstances, would have been holder in due course of the cheque; entitled to enforce payment of it both against B and A. No sound business-man would change a not negotiable cheque for a stranger. Indeed, it is not the practice of sound business-men to negotiate cheques at all. The practice is to pay them into the bank as quickly as possible for collection. But cheques are not uncommonly negotiated by private persons.

Forged Cheques.—It is said that a banker is bound to know his customer's signature, so that if a customer's signature to a cheque is forged, and the banker pays it, he cannot debit the customer's account with the payment. But the real ground of the bankers' liability when he pays a cheque bearing a forged signature is that he has paid away his customer's money without authority to do so, on an instrument that is not a cheque, but a mere piece of paper. S. 24 of the Act, quoted on p. 778, defines the banker's liability if he pays a bill or cheque containing a forged signature. The only case where a banker may be entitled to debit his customer with payment of a cheque bearing the forged signature of the drawer is where the customer is estopped or precluded from setting up the forgery, because by his conduct he has misled the banker, or induced him to believe the signature to be genuine, or has not repudiated the forged signature as soon as it has come to his notice.

Fraudulent Raising of Amount of Cheque.—A customer is bound to exercise reasonable care in drawing cheques to prevent the banker from being misled, and if he does exercise reasonable care, and nevertheless the cheque is fraudulently raised in amount, and the banker pays it, the banker cannot debit the customer with any greater sum than that for which the cheque was originally drawn. But where the customer negligently though innocently draws a cheque in such a manner as to facilitate fraud, *e.g.* where he leaves blank spaces or affords other opportunities for increasing the amount of a cheque, he is guilty of a breach of duty to the banker, and is responsible to him for any loss that is the natural and direct consequence of his breach of duty (*London Joint Stock Bank* v. *Macmillan and Arthur*, (1918)). But the banker himself may be precluded from setting up the breach of duty against the customer in cases where, by the exercise of reasonable care, he could have detected the fact that the cheque had been tampered with.

Forged Indorsement.—A banker's duty with regard to indorsements on cheques is to see that they are correct as to form. If he pays a cheque, an indorsement whereon is irregular, he is liable to the true owner of the cheque should the indorsement be forged or unauthorised. But the paying banker, although he may satisfy himself that the indorsements are correct as to form, is not in a position to know whether the signatures are authentic. Accordingly, the Act affords him protection. By S. 60, where a cheque bears a forged or unauthorised indorsement, and the banker pays it in good faith and in the ordinary course of business, he is deemed to have paid the cheque in due course, although such indorsement has been forged or made without authority. S. 60 applies only to cheques, not to other bills of exchange, and only to cheques payable to order, whether crossed or uncrossed. A cheque originally drawn payable to bearer need not be indorsed, and if any indorsements appear thereon the banker may ignore them.

Payment of Crossed Cheques.—By S. 79, where a cheque is crossed specially to more than one banker, except when crossed to an agent for collection being a banker, the banker on whom it is drawn shall refuse payment thereof. If a banker pays a cheque so crossed, or if he pays a cheque crossed generally to any one but a banker, or if he pays a cheque crossed specially to any but the banker named, he is liable to the true owner of the cheque for any loss the true owner may sustain owing to the cheque having been so paid. Unless a banker pays a cheque strictly in accordance with the crossing, he is guilty of negligence and cannot debit his customer's account with the payment.

But protection is afforded to the paying banker by S. 80, which says that if a banker on whom a crossed cheque is drawn pays it in good faith and without negligence to a banker, if the cheque is crossed generally, and to the banker named, or his agent for collection being a banker, if it is crossed specially, then the banker paying the cheque, and, if the cheque has come into the hands of the payee, the drawer, shall respectively be entitled to the same rights and be placed in the same position as if payment had been made to the true owner of the cheque.

Collection of Cheques.—The five paragraphs above deal with the perils that confront the banker paying cheques, and the statutory protection afforded to him, in certain circumstances, by SS. 60 and 80 of the Act. The collecting banker, *i.e.* the banker who receives payment, has also to face certain risks; and is also, in certain circumstances, afforded statutory protection.

In general, the position of a banker who collects a cheque for his customer depends upon the customer's title to the cheque. A banker who collects an uncrossed cheque for a customer, to which the customer has a defective title, or on which there is a forged indorsement, is entirely without protection, and is liable to the true owner of the cheque for conversion or for money had and received to his use, and the banker can look only to his customer for indemnity. By "conversion" is meant the "wrongful intermeddling with the goods of another for the purpose of taking them away from the party entitled to them" (Hart, *Law of Banking*, 3rd edn., p. 545). But if the banker be holder for value of an uncrossed cheque, or of a crossed cheque that is not marked "not negotiable," as, *e.g.* where he credits the cheque to his customer as cash, and by definite agreement expressed or implied allows him to draw against the cheque before clearance, then, in the case of defective or no title in the customer, he is holder of the cheque for value with a good title to sue all parties to the cheque; and, in the case of forged indorsement, though he is liable to the true owner of the cheque, he has rights against indorsers subsequent to the forgery, if any there be.

The protection afforded to the banker collecting crossed cheques is contained in S. 82 of the Act. That section says where a banker in good faith and without negligence receives payment for a customer of a cheque crossed generally or specially to himself, and the customer has no title or a defective title thereto, the banker shall not incur any liability to the true owner of the cheque by reason only of having received such payment. By the *Bills of Exchange (Crossed Cheques) Act*, 1906, a banker receives payment of a crossed cheque for a customer within the meaning of S. 82, notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof.

It is to be observed that the banker must not only receive payment in good faith and without negligence, *e.g.* he must see that the indorsements purport to be correct and in order, but the cheque must be collected for a customer. The term "Customer" is not defined in the Act, but it seems to be essential that to be a customer of a bank one must have some sort of account with the bank and that a casual service performed by a banker for a person, *e.g.* where a banker cashes a cheque for a person introduced by a customer of the bank, does not make that person a customer.

Non-Transferable Cheque.—Every cheque is transferable that does not contain words prohibiting transfer, or indicating an intention that it shall not be transferable (S. 8 (1)). To make a cheque non-transferable, it must be drawn in such a way as to leave no doubt of the drawer's intention. The words "order" or "bearer" should be deleted; the payee should be named restrictively, *e.g.* " Pay James Brown only "; and the words " not transferable " should be plainly written across the face of the cheque. A non-transferable cheque is a mere mandate for the payment of money to a named payee, and the negation of a negotiable instrument. It must not, as it sometimes is, be confused with a cheque marked " not negotiable."

Alterations on Cheque.—Every material alteration on a cheque requires to be attested by the drawer's full signature or his initials appended to the alteration. Thus where the date or amount is altered, or the word " order " is changed to " bearer," etc., the drawer must add his initials or his signature to the alteration in order to authenticate the alteration.

Marked Cheque.—Bankers sometimes place their initials upon cheques, and by so doing certify them as good for payment. This marking may be done at the request of the drawer, or of the banker collecting the cheque. If a cheque is marked at the drawer's request, the banker is entitled to retain in hand sufficient funds to pay the cheque, and to dishonour other cheques of the drawer, if payment of these cheques would reduce the customer's balance below the amount required to meet the marked cheque; and the drawer cannot countermand payment of the cheque, which, by the marking, has been constructively paid. Marking at the customer's request is not encouraged by bankers. They prefer to give their own draft in exchange for the cheque.

Marking at the request of the collecting banker is a recognised banking practice. When a cheque is received too late in the day for presentation through the Clearing House, it is taken, where circumstances make that course desirable, direct to the drawee banker, who, if he holds sufficient funds of the drawer, marks it as good for payment next day. In this case the marking constitutes a complete appropriation of funds in the hands of the paying banker to the collecting banker in the ordinary course of business, and amounts to constructive payment of the cheque. Such marking precludes the customer countermanding payment of the cheque.

Stale Cheques.—The word " stale " in connection with cheques may have reference to the negotiability of the cheque, or to the banker's duty to pay the cheque on presentation. From the point of view of negotiability, a cheque, in the absence of special circumstances, would be regarded as stale, *i.e.* as having been in circulation for an unreasonable length of time, after the lapse of about ten days from the date of issue. A person who takes a cheque that has been in circulation for an unreasonable time may be considered to have taken it with notice of any defect in the title to the cheque of the person from whom he took it, and, therefore, in the event of a defective title in his transferor, be debarred from recovering the amount from prior parties to the cheque. As regards payment, banking practice differs. One banker might consider a cheque to be stale, and require the drawer's confirmation before he paid it, if it had been outstanding for six months from its date. Another banker might pay a cheque that had been outstanding for twelve months. Here, as in other connections, the banker would have regard to the special circumstances of the case.

Post-Dated Cheques.—A post-dated cheque is a cheque that bears a date posterior to the date of its issue. It is perfectly valid for purposes of negotiation, but if a banker pays such a cheque before its due date, he loses his statutory protection as paying banker, and must bear any loss that results from his having so paid. Indeed, it is doubtful if he can in any circumstances debit such a payment to his customer if the customer objects. Further, if having paid a post-dated cheque before its due date, the banker were to dishonour other cheques not post-dated, because by payment of the post-dated cheque the customer's balance had been depleted, he would be liable to his customer for damage to credit.

Statutes of Limitations.—All contracts by bill of exchange are simple contracts, and the drawer, acceptor, and indorsers of a bill, or the drawer and indorsers of a cheque, or the maker and indorsers of a promissory note remain liable upon the instrument for its amount for a period of six years, after which time all claims are barred by the *Limitation Act*, 1939. But this Statute does not apply to bank notes, the issuers of which are liable upon them no matter how long they have been in circulation. In the case of a cheque, if the drawer suffers loss through the holder's delay in presenting the cheque; if, *e.g.* the holder held the cheque for an unreasonable time, and the banker failed before the cheque was presented for payment, and the drawer was creditor of the banker for a larger sum by the amount of the cheque than he would have been had the cheque been presented and paid, then the holder could not recover from the drawer, but must claim against the banker's estate. If the debtor gives an acknowledgment of the existence of the debt, or makes a payment on account, the six years will run from the date of the acknowledgment or payment; to be effective for this purpose, however, any such acknowledgment must be in writing, signed by the debtor or his authorised agent.

III. PROMISSORY NOTES.

A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer (S. 83 [1]).

An instrument in the form of a note payable to the maker's order is not a note unless and until it is indorsed by the maker (S. 83 [2]).

A note may contain a pledge of collateral security, and, in case of default by the maker, confer authority to sell or dispose of the security deposited by the maker (S. 83 [3]). As in the case of a bill, the sum for which a note is made may be payable by instalments, or with interest, etc.

A note which is, or on the face of it purports to be, both made and payable within the British Islands is an inland note. Any other note is a foreign note (S. 83 [4]).

No precise form is laid down for a note. So long as in form it satisfied the above definition it is valid.

The following is a common form of note:—

> **£100.** London, 8 John Street, W.C. 1.
> *January* 15, 19...
>
> 1s.
>
> On demand I promise to pay to Mr. George Watson the sum of One Hundred Pounds value received.
>
> Soames Walker.

Whereas to a bill of exchange and a cheque there are primarily three parties, to a note there are primarily two, viz. the maker and the payee. The maker of a note corresponds to the acceptor of a bill, and the first indorser of a note to the drawer of an accepted bill payable to drawer's order (S. 89 [2]). The maker of a note is the person primarily liable thereon; the drawer of a bill is liable thereon only if it has been negotiated, and the drawee does not accept or pay the bill.

The maker of a note engages that he will pay it according to its tenor, and is precluded from denying to a holder in due course the existence of the payee and his then capacity to indorse (S. 88).

The law as to bills of exchange applies with the necessary modifications to promissory notes (S. 89 [1]). The provisions as to presentment for acceptance, acceptance, acceptance *supra* protest, bills in a set, do not apply to promissory notes, and where a foreign note is dishonoured protest is unnecessary (S. 89 [3]).

Joint and Several Notes.—Where a bill is accepted by two or more persons who are not partners, the acceptors are jointly liable thereon, and, in case of default, all should be sued, for if one only is sued, and judgment is obtained but is not satisfied, no action can lie against the other acceptors. But if a note is made by two or more makers, the makers may be jointly liable or jointly and severally liable. If the liability of the maker is joint and several, one maker may be sued alone, and if the judgment obtained against him is unsatisfied, the other maker or makers may each be severally proceeded against in turn, until judgment is fully satisfied; or, alternatively, all the makers may be sued together. It depends upon the form of the note whether the liability of the makers is joint, or joint and several. If a note reads "We promise to pay" and is signed by two or more makers, the liability is joint; if a note reads "I promise to pay," and it is signed by two or more makers, the liability of the makers is joint and several.

If a note is in the body of it made payable at a particular place, it must be presented for payment at that place in order to render the maker liable. In any other case no presentment for payment is necessary in order to render the maker liable. Presentment for payment is necessary to make an indorser liable; and if a note is in the body of it made payable at a particular place, the note must be presented for payment at that place. Where a place of payment is mentioned, not in the body of the note, but by way of memorandum only, presentment at that place will make an indorser liable, but a presentment to the maker elsewhere will also make him liable (S. 87). If a note is dishonoured, due notice of dishonour must be given to an indorser. Presentment for payment of a note may be excused on the same grounds as presentment for payment of a bill is excused.

A note payable on demand that has been indorsed must be presented for payment within a reasonable time of the indorsement, otherwise the indorser is discharged. A note payable on demand that has been negotiated is not deemed to be overdue so as to affect the holder with defects of title of which he had no notice, because a reasonable time for presenting it for payment has elapsed since its issue (S. 86). Notes are frequently made with the intention that they shall form a continuing security. Hence this difference in the law between bills and notes.

Stamping Notes.—The scale for stamping is given on p. 769. It is to be noted that a bill payable on demand is stamped 2*d.* for any amount; a note payable on demand is stamped *ad valorem.*

Bank-note.—A bank-note is a promissory note made and issued by a banker payable to bearer on demand. Until recently bank-notes could not be issued in England (though they could in Scotland and Ireland) for less than £5. *The Currency and Bank Notes Act*, 1928, however, authorised the Bank of England to issue notes of £1 and 10*s.* denomination, and these have since been in common use, replacing the Treasury Notes (issued by the Government), which previously served as currency.

I O U.—An I O U is an acknowledgment of indebtedness for a stated sum signed by the giver, who may be sued at any time thereon for a period of six years from its date. If the I O U contains, besides the mere acknowledgment of indebtedness, a promise to pay, it may constitute a promissory note.

EXAMINATION QUESTIONS.

1. What are the characteristics of a negotiable instrument? Give examples of such instruments. Is a bill of lading a negotiable instrument?

2. Explain the uses in commerce of the bill of exchange.

3. Give the legal definition of a bill of exchange and comment upon the several clauses of the definition.

4. Give the stamp duty on the following: (*a*) Inland bill drawn at 3 d/s for £850; (*b*) Inland bill drawn at 90 d/d for £535; (*c*) Foreign bill drawn at 3 m/d for £620, payable in Berlin, indorsed in London; (*d*) Promissory Note for £1,000 payable on demand.

5. Why is a bill drawn after sight or date presented for acceptance? Show alternative forms of acceptance by Smart & Co., the drawees of a bill. What is a general and what a qualified acceptance? If C. Seed, the holder of a bill, takes a qualified acceptance on a bill that has been negotiated several times, what must he do to bind the indorsers?

6. Give the rules as to presentment for acceptance of a bill; also the rules as to presentment for payment.

7. What are days of grace? Give the due dates of the following bills: (*a*) bill dated June 30 payable at 1 m/d; (*b*) bill dated December 31 payable at 3 m/d.

8. In what ways may a bill be dishonoured? What must the holder of a dishonoured bill do before he can take action on the bill?

9. State what you know as to the giving of notice when a bill has been dishonoured.

10. Of what does noting and protesting a bill consist? Is it necessary to note a dishonoured inland bill, or to protest it; if so, when?

11. What is a case of need? Explain acceptance for honour *supra* protest, and payment for honour *supra* protest.

12. The damages upon dishonour by non-payment of a bill are liquidated damages. Explain this, and the extent of the damages recoverable.

13. Define, respectively, the liability of: (*a*) the acceptor, (*b*) the drawer, and (*c*) an indorser of a bill. What is the drawer's remedy against the drawee of a bill dishonoured by non-acceptance?

14. Differentiate between a holder and a holder in due course of a bill, and simply explain the difference by an illustration.

15. What do you understand by the negotiation of a bill? A bill is made payable to A. B. How is it negotiated? Explain the terms "indorsement in bank," "special indorsement," and "restrictive indorsement."

16. Explain the law of agency in connection with the drawing, acceptance, and negotiation of bills. What is the effect of indorsing a bill "sans recours," and when is it done?

17. Mention the five ways in which a bill of exchange may be discharged.

18. What is an accommodation party, and an accommodation bill? A bill is paid by an acceptor who has accommodated the drawer of the bill. Is the bill discharged by the payment?

19. Wherein does a cheque differ from a bill of exchange?

20. Illustrate two general crossings of a cheque and two special crossings. What is the effect of adding to a crossing the words "not negotiable"?

21. A customer adds to the crossing of a cheque the words "Payee's Account only." Discuss this addition from the point of view of the drawee banker.

22. Drawee's signature to a cheque is forged and the cheque is paid by the banker. Can the banker debit the payment to the drawer; if so, when?

23. A customer negligently draws a cheque. It is fraudulently raised in amount by the payee, and the banker pays the increased amount. Discuss the banker's position: (*a*) if the alteration were apparent; (*b*) if it were not apparent.

24. What is the banker's duty as regards the payment of crossed cheques? State the measure of the protection afforded to the banker paying a crossed cheque by S. 80 of the *Bills of Exchange Act*.

25. A banker collects a crossed cheque for a customer who has a defective title to the cheque. In what circumstances is the banker protected in so doing? Supposing the cheque were uncrossed, what then is the banker's position?

26. What is a non-transferable cheque, and what is a marked cheque?

27. Discuss the question of stale cheques from the point of view: (*a*) of payment; (*b*) of negotiability.

28. Define a promissory note. What is a joint note, and a joint and several note?

29. A banker pays a post-dated cheque, and subsequently dishonours cheques not post-dated. Discuss the banker's position.

30. Define a bank-note. What is an I O U and when may it amount to a promissory note?

31. Explain the phrase "exchange as per indorsement," and also what is meant by "re-exchange."

INDEX

Absorption (Company), 467, 471

Acceptances, 758; General, 770; Qualified, 771, see also under *Bills of Exchange*

Account Sales, 245

Accounts, Preparation of, in examination work, 105

Actuaries, 730

Adjustments, Between Capital and Revenue, 39; Necessary before preparation of Annual Accounts, 37

Advertising Expenses, Treatment of, 33

Agenda Book, 319

Agent, Liability on bill, 781

Allonge, 780

Allotment, Letters of, 291, 296

Allotment, Return of, 320

Allotment Returns, Register of, 320

Allotment Sheets, Register of, 320

Amalgamation (Company), 464, 471; Relief from Capital and Transfer Stamp Duty in, 473

Ammonia Soda Co. v. Chamberlain [1918], 66, 89

Amortization, meaning of, 40

Anglo-French Music Co. v. Nicol [1921], 303

Annual General Meeting, 342

Annual Report and Accounts (Company), 366, 486, 487

Annual Return, 324; Particulars of, 324; Illustration of, 325

Annuities (Assurance), 731

Annuity Method of Distributing Depreciation, 44, 90

Application and Allotment Sheets, 289, 293, 357

Application Form (Company), 289, 292

Apprentices' Premiums, Treatment of, 25, 36

Appropriation Account, 66, 67; Directors' Report and, 67; Dividends and, 360, 362; Example of, 67; Partnership and, 160; Profit and Loss Account and, 66, 492; Treatment of, 66, 492

Articles of Association, 265, 267, 268, 272; Alterations in, 272; Borrowing powers and, 309; Calls and, 361; Contents of, 274; Directors and, 281; Dissentient Shareholders and, 471; Goodwill, writing down of, and, 92; In what way binding, 272; Issue of balance of shares under, 289; Liens and Charges and, 389; Meetings and, 342; Payment of Interest out of Capital and, 419; Provisions of, 272; Proxies and, 342, 344; Seal (Company) and, 280; Quorum and, 345; Reduction of Capital and, 422, 454; Return of Capital to Shareholders and, 432; Splitting of Shares and, 416; Stock, issue of, and, 306; Surrender of Shares and, 389; Table A and, 273

Asset Redemption Account, 54

Assets, kinds of, 87; Balance at Bank and, 90; In Balance Sheet, 87; Copyrights and, 99; Current, 87; Dilapidations and, 90; Fixed, 94–97; Furniture, Fixtures and Fittings, and, 99; Goodwill and, 90; Investments and 99; Land and Buildings and, 89; Lease premium, treatment of, 89; Loose Tools and, 97; Machinery and Plant and, 93; Mines and Quarries and, 100 Patents and, 97; Stock in Trade and, 101; Sundry Debtors and, 101 Trade Marks, Patterns, Dies, Drawings and, 97; Of Unrealisable value, 87 Work in Progress and, 101

Assurance (Life), 729, 735; Annuities and, 731; Assignment of policy of, 732 Bonuses on, 733; Claims on, 733; Classes of, 729; Definitions of, 729 Endowment Policies of, 733; Expectation of life and, 730; Funds of investment of, 734; Industrial and, 729; Insurable Interest, 731; Kinds o Insurance, 730; Kinds of Offices, 729; Lapsed Policies of, 731; Mean after-lifetime, 730; Mixed offices for, 729; Mortality Tables, 730; Mortgage of Policy of, 733; Mutual offices for, 729; Policies, kinds of, 730; Premiums of

729, 731, 735; Profits of, 734; Proposal, form of, 729; Proprietary Offices of, 729; Quinquennial Valuation and, 734, 736; Re-assurance and, 731; Surrender value of policies and, 731; *Uberrimæ fidei* and, 729; Valuation Balance Sheet and, 735; Valuation Premiums, 735; "With or without Profit", 733. See also under *Accounts*

ASSURANCE ACCOUNTS, 735; Balance Sheet of, 735; Deposit required, 735; Schedules, illustrated, 737, 738, 739, 740, 741

Assurance Companies Act, 1909, 734, 735

ASSURANCE POLICY, 732

Atlantic and Pacific Fibre Importing and Manufacturing Co. [1928], 366

AUDITORS, Appointment and remuneration, 286; Liability of, 288; Rights and duties of, 286, 287, 288; Report, specimen of, 287; Report on Consolidated Accounts, 531; Who may not be appointed, 286; Valuation of Shares by, 484

AUTHORISED CAPITAL, 300

BAD DEBTS PROVISION, 62

BAILEE, BANKER AS, 760

BALANCE AT BANK, Treatment of, 90

BALANCE SHEET, 79, 80; Assets and liabilities in, 82, 87; Assets of unrealisable value and, 87; Assets, valuation of, and, 87; Assets, Current, and 87; Assets, Fixed, and 87, see also under *Assets*; Auditors and, 80, 286, see also under *Auditors*; Balance at Bank and, 90; Bankers, inspection of, 88; Basis of, 75; Calls and, 103, 104; Capital and, 103; Capital Redemption Reserve Fund and, 104; Circulation of, 491; Compulsory, 80, 487; Contents of, 496; Contingent Liabilities and, 105; Copyrights and, 90; Creditors and, 104; Debentures and, 103, 412, see also under *Debenture*; Debtors and, 101; Deferred Revenue Expenditure and, 102; Development Expenditure and, 93; Directors and, 80; Directors' Loans and, 87; Directors' Report and, 487; Discount Provision and, 32; Errors in drawing up, 111; Fixed Assets, presentation in, 94–97; Forfeited Shares and, 103; Forms of, 81; Furniture, Fixtures and Fittings and, 99; Goods on Consignment and, 17; Goodwill and, 87, 90; Heading of, in Error, 82; Information afforded by, 82; Insurance and, 33; Interest accrued due and, 100; Investments and, 99; Land and Buildings and, 89; Liabilities and, 103; Limited Companies and, 80; Loans by Company and, 101; Loose Tools and, 97; Machinery and Plant and, 93; Maintenance Fund and, 105; Marshalling of Assets and Liabilities in, 82; Mines and Quarries and, 100; Partnership and, 156; Patents and, 97; Premiums and Discounts and, 397; Preparation of, in examination work, 105; Quoted Investments and, 87; Reserves and, 105; Responsibility for, 80; Signing of, 491; Stock in Trade and, 101; Tax Reserve Certificates and, 87; Trade Investments and, 87; Trade Marks, Patterns, Dies, Drawings and, 97; Unquoted Investments, 87; Work in Progress, 101

BALANCE SHEET (COMPANY), Contents of, 489, 496

BALANCE TICKETS, 340

BALANCING LEDGERS, 8

Bale v. *Cleland*, 34, 416

BANK BOOK-KEEPING, 744; Acceptance Ledger, 758; Acceptances and, 764; Accounts, presentation of, 496; Bank of England Book, 753, 754; Bill Diary, 756, 758; Bill Ledger, illustrated, 757; Bills Discounted Register, illustrated, 757; Bills of Exchange and, 756, see also under *Bills of Exchange*; Current Account Ledgers and, 749; Day Book and, 749; Deposits and, 747, 753; Deposits Diary, 755; General Cash Book and, 750; General Ledger and, 747; Goldsmith's Book and, 754; Lien, 760; Loans to customers, 760; Loans Ledger, 760; Pass Books and, 746; Paying Cashier's Counter Cash Book and, 753; Received Counter Cash Book and, 753; Securities and, 758; Securities Received Register, 759; Short Bills, 756; Slips, 744; "Walks" Clerk, 753

BANK OF ENGLAND BOOK, 754

BANKER'S LIEN, 760

Bankruptcy Acts, 1914 and 1926, 691, 701

BANKRUPTCY, Acts of, 692; Adjudication Order, 696; After acquired Property, 698; Allowance in kind, 696; Audit of Accounts, 720; Bankruptcy Estates

Account, 720; Committee of Inspection and, 698; Creditors and, 694; Debts not provable in, 699; Debts provable in, 699; Deeds of Arrangement in, 691, 722, see also under *Deeds of Arrangement*; Deferred Debts, 699; Discharge from, 701; Dividends in, 714; Execution Creditors in, 700; First Meeting of Creditors, 696; Foreigners and, 691; Fraudulent Preference and, 714; Infant and, 691; Insolvency and, difference between, 691; Landlord and, 695; Lunatics and, 692; Married Women and, 691; Official Forms in, 702–712; Official Receiver in, 692; Partnership and, 700; Petition, 692; Preferential Creditors, 694; Proof of Debts in, 698; Property (divisible) in, 697 (After-acquired), 698; Public Examination, 695; Receiving Order, 692, 693; Release of a Bankrupt, 714; Rent in, 695; Secured Creditors in, 699; Small, 696; Special Manager, 696; Trustee in, 713, see also under *Trustee in Bankruptcy*; Undischarged Bankrupt, 704; Voting letter and, 696; who may be made Bankrupt, 691

BANKRUPTCY ESTATES ACCOUNT, 720

Bankruptcy Rules, 1915–1926, 691, 692

Bardwell v. *Sheffield Waterworks Co.*, 102

BEARER SECURITIES, Coupons and, 760; Dividends on, 348

Bennett's Case [1854], 335

BILL DIARY, 757

BILL DISCOUNTED REGISTER, 757

BILL LEDGER, 757

BILL OF EXCHANGE, 756, 763; Acceptance and payment for honour of, 776; Acceptance of, 770–771; Acceptor of, 778; Accommodation Parties to, 782; Agent, liability of, on, 781; Alteration of, 782; Allonge on, 780; Amount recoverable on, 777; Bills in a set, 783; Days of Grace on, 773; Discharge of, 781; Discounting a, 756, 764; Dishonour of, 774, 775; Drawee and Drawer of, 765, 766, 768; Examples of, 767; Exchange as per indorsement, 768; Foreign, 769, 776; Forged Signature to, 778, 780; General Acceptance of, 771; Holder for Value of, 756, 788; Holder of, 779; Holder in due course of, 778, 779; Indorsement in blank of, 780; Indorsements, 780, 781; Inland, 771, 776; Legal definition of, 764; Liability of parties to, 778; Negotiation of, 780; Negotiable Instruments, 782; Noting of, 776; Payment for Honour supra protest of, 776; Presentment for Payment of, 772; Parties to, 766; Payee of, 766; Principal and Agent, 781; Protesting of, 776; Qualified Acceptance of, 771; Referee in Case of Need, 777; Rules for Presentment of, 772; Sans Recours, 781; Secunda Via, 783; Stamp Duty on, 769; Signature by Procuration on, 781; Uses of, 764; Valuable Consideration defined, 779

BILLS FOR COLLECTION, 756

BILLS IN A SET, 783

Bills of Exchange (Crossed Cheques) Act, 1906, 763, 788

Bills of Exchange (Time of Noting) Act, 1917, 763, 776

BIN CARDS, 644

Blair v. *Bromley*, [1847], 127

BLANK TRANSFER, 340

Bloomenthal's Case [1897], 341

BONUS SHARES, 305, 379

BORROWING POWERS (COMPANY), 309

Boschoek Proprietary Co. v. *Fuke* [1926], 282

BOUGHT LEDGER, 7

Bovill's Act, 1865, 219

BRANCH ACCOUNTS, Agency, branch as, 589; Branch as independent trader, 589; Branch Capital Expenditure, Fluctuating Currency, 635; Branch Ledger at Head Office, 631; Central District Depots, 590; Closing Stock in, method of treating, 600; Depreciation of Assets and, 607; Double Column, 600; Duplicate Branch Ledger, 603; Final Accounts of, 607; Fluctuating Exchange assumed to be Stable, 631; Foreign Branch Accounts, see under *Foreign Branch Accounts*; General Principles of, 587; Head Offices makes all Purchases, 590, 591; Independant Trader, Branches as, 589; Inter, 602; Kinds of Branches, 589; Local Stores account in Sterling, 636; Methods of invoicing goods to, 589; Multiple Shop Concerns, see under

Multiple Shop Concerns; "One Account" System, 600; Profit and Loss on exchange, treatment of, 631; Requirements of Efficient System and, 587; Rules for Reconciling, 603; Stock at Loaded Prices and, 596; Suspenses Account, 600; Transactions in Foreign Currency, 634; Warehouse Expenses and, 607; Weekly Returns, illustrated, 605; Where H.O. makes all Purchases, 590

BROKERAGE (COMPANY), 285; Confusion between, and Underwriting Commission, 285

Buchan's Case [1879], 337

BUILDINGS, Valuation of, 89

Burnham Case, 399

BUSINESS, Conversion of into Company, 440, 473, 482; Losses of, prior to incorporation as company, 484; Profits of, prior to incorporation as company, 482; Purchase of, 440

BY-PRODUCTS (COST ACCOUNTS), 661

CALL BOOK, 320

CALL LETTER, 297

CALLED-UP CAPITAL, 300

CALLS, 291, 361; In advance, 298; In advance, interest on, 361; In arrears, 298; In arrears, interest on, 363; Letter, 297; Making, 291; Stock Exchange Quotation and, 361; Table A and, 291, 361, 363; When due, 136; When payable, 291; When statute-barred, 291

CAPITAL, Authorised (Nominal or Registered), 300; In Balance Sheet, 103; Called up, 300; Circulating, 366; Fixed, 366; Increase of, 421; Issue of, example of, 315; Issued, 300; Issue of balance of, 289; Of a Company, 300, 315; Interest paid out of, 419; Loan, 300; Paid-up, 300; Reduction of, 422, 423; Reserve liability on, 300; Return of, to Shareholders, 432; Share, 271; Subscribed, 300; Working, 300

CAPITAL EXPENDITURE, difference between, and Revenue Expenditure, 27, 37

CAPITAL REDEMPTION RESERVE FUND, Treatment of, in Balance Sheet, 104

CAPITAL RESERVE, 64

CARRIAGE, INWARD AND OUTWARD, 25, 30

CERTIFICATES AND BALANCE TICKETS, REGISTER OF, 320

CERTIFICATION, 341

CHARGES, REGISTER OF, 319

CHATTELS, 125

CHEQUE, 783; Additions (non-statutory) to crossing of, 785; Alterations on, 789; Collection of, 787; Conversion of, 788; Crossed, payments of, 787; Crossing of, 784; Defined, 783; Dishonour of, 783; Forged, 786; General crossing of, 784; Indorsement of, 785; Marked, 784; Non-statutory additions to crossing of, 785; Not Negotiable, 786; "Not Sufficient", 784; Non-Transferable, 788; Parties to, 786; Post-dated, 790; "Refer to Drawer", 784; Special Indorsement of, 784; Stale, 789; Statutes of Limitations and, 790; Uncrossed, 785

CHOSES IN ACTION, 125

City Equitable Fire Insurance Co. Ltd., 288

Civil Procedure Act, 1883, 366

COLLATERAL SECURITY, Debentures as, treatment of, 103

COMMISSION, Treatment of, 33

COMMITTEE OF INSPECTION, 698, 714

COMMON SEAL, Use of, 283

COMPANY, see under *Limited Company*

COMPANY DEPRECIATION ACCOUNTS, Examples of, 49, 50, 51, 52, 53

COMPANY LIMITED BY GUARANTEE, 262

COMPANY MEETINGS, 342

COMPANY RESOLUTIONS, 343; Special, 343; Extraordinary, 343; Ordinary, 343

CONSIGNMENT ACCOUNTS, Account Sales and, 245; Consignee and, 245; Consignee's Books, 247; Consignor and, 245; Consignor's Books, 246; Definition of, 245; Del credere commission and, 245; Pro-forma invoice and, 245

CONSOLIDATED ACCOUNTS, 526; Accounts, illustrated, 536, 537, 562; Accounts of Subsidiary, 530; Auditors' Report, 531; Equity Share Capital of, 527;

Financial Year of subsidiary, 529; Group Accounts, when necessary, 528; Holding Company defined, 527; Loss of Subsidiaries, 556; Method of preparing, 531; Rules as to, 530; Schedule, illustrated, 542, 561; Specific Rules as to accounts of Holding Company, 529

CONTINGENT LIABILITIES, 61; Treatment of in Balance Sheet, 105

CONVERTIBLE PREFERENCE SHARES, 303

Cook v. *Barry, Henry & Cook, Ltd.* (1923), 290

CO-PARTNERSHIP SHARES, 305

COPYRIGHTS, Valuation of, 99

CORPORATE BODY, Defined, 261

COST ACCOUNTS AND COSTING, 652; Advantages of, 653; Bonus or Premium Systems of, 658; By-products and, 661; Cost Ledger and, 661; defined, 653; Departmental Costing, 655; Devising a system, 655; Direct Labour and, 656; Elements of Cost and, 656; Entries in Books of, 660; Job costing, 654; Labour Hours and, 656, 657; Labour abstracts and, 658; Machine Hour method, 659; Materials and, 658; Multiple Costing, 655; Office and Administrative Oncosts, 660; Oncost and, 655, 658; Operating or Working Costing, 655; Percentage Method and, 659; Primary Allocations and, 660; Prime Cost and, 655; Principles of, 653; Process Costing, 655; Productive Hour method of, 659; Single or Output Costing and, 654; Systems of, 654; Terminal, job, or Contract, costing and, 654; Total Accounts and, 661; Total (Gross Production) Cost and, 656; Unrealised Profits taken on Process Costing, 664

COUPON LIST, Specimen of, 400

Cox v. *Hickman* (1860), 120

Cruikshank v. *Sunderland* [1922], 123, 210

Cum Div., 375

CUMULATIVE PREFERENCE SHARES, 303

CURRENT ASSETS, 87

DAYS OF GRACE, 773

DEBENTURES, as Collateral Security, treatment of, 103, 412; Balance Sheet and, 103, 412; Bearer, 310; Bonds, 310, 397; Conditions of Issue, 311, 312; Coupons, 310, 397; Defined, 309; Deposited to secure advances, 412; Expenses of issuing, 397; First Mortgage, 309; Form of, 310; Holders, Receiver for, 313, 314; Interest on, 310, 397; Irredeemable (Perpetual), 310; Issue of, 310, 391; Kinds of, 310; Nature of Charge, 309; Notes, difference between and, 315; Purchase of in open market, 395; Receiver for Holders of, 313; Redemption of, 314, 399; Registered, 313; Re-issue of, 314, 405; Rights of Holders of, 314; Second Mortgage, 309; Simple, 310; Stock, 310; Talon on, 310; Trust Deed, 311; Trustees, 311; Warrant, 401

DEBENTURE HOLDERS, REGISTER, 320, 333, 334

DEBENTURE INTEREST BOOK, 320; Specimen of, 400

DEBENTURE INTEREST WARRANT, Specimen of, 401

DEBENTURE STOCK, 310

DEBENTURE STOCK ACCOUNT, Illustration of, 407

DEBENTURE STOCK HOLDERS, REGISTER OF, 320, 334

DEBENTURE TRANSFERS, 341

DEBENTURE TRUST DEED, 311

DEED OF ASSIGNMENT, 722

DEED OF COMPOSITION, 722

DEEDS OF ARRANGEMENT, 722; Trustee in, 723

Deeds of Arrangement Act, 1914, 722

DEFERRED MANAGEMENT AND FOUNDERS' SHARES, 304

DEFERRED REVENUE EXPENDITURE, Treatment of, 35; In Balance Sheet, 103

DEFERRED STOCK, 307

DEL CREDERE COMMISSION, 245

DEPARTMENTAL ACCOUNTS, 579; Allocation of Expenses in, 582; Combined Accounts, form of, 586; Credits to Profit and Loss Account and, 585; Gross Profit and, 582; Interdepartmental transactions and, 585; Necessity for sub-division, 579; Other Trading Account Debits and, 582; Profit and Loss

Account and, 582; Purchases Book, 580; Purchases, treatment of, 579; Sales and, 580; Stock and, 582; Trading and Profit and Loss Accounts illustrated, 583, 584

DEPRECIATION, Accumulated, reserve for, 63, 64; Annuity, method of, 44; Assessment, methods of, 41; Charge against profits, 49; Company depreciation accounts, examples of, 49, 50, 51, 52, 53; Defined, 40; Diminishing Balance, method of, 42; Fluctuation in value and, 40; Insurance Policy method of, 45; Legal and Commercial views on, 49; Provision for essential, 40; Provisions, Limited Companies, 47, 49; Sinking Fund method of, 45; Straight-line method of, 42; Valuation method of, 47

DEVELOPMENT EXPENDITURE, Treatment of, 102

Dickson v. *National Bank of Scotland* (1917), 134

DILAPIDATIONS, treatment of, 102

DIMINISHING BALANCE METHOD OF DISTRIBUTING DEPRECIATION, 42

DIRECTORS, 281; Age limit of, 283; Calls and, 361; Compensation for loss of office and, 282; Dividends and, 364; Duties of, 281; Fees, 28; (free of tax) 282; How appointed, 281; Liability of, 281; Managing, 281; Power and duties of, 281, 282; Remuneration of, 282; Report of, 366, 487

DIRECTORS' ATTENDANCE BOOK, 320

DIRECTORS' FEES, 28

DIRECTORS' LOANS, 87; Treatment of, 90

DIRECTORS, PARTICULARS OF, Illustration, 327

DIRECTORS, REGISTER OF, 319

DIRECTORS' REPORT, 487

DIRECTORS AND SECRETARIES, REGISTER OF, 331

DISCOUNT, Provision for, 33, 64; Trade, 23

DISCOUNTING A BILL, 756, 758, 764

DISHONOUR OF A BILL, 774; (Amount recoverable on), 777; Measure of damages on, 777; Of cheque, 783

DISTRINGAS, 390

DIVIDEND BOOK, 320, 374

DIVIDEND EQUALISATION FUND, 63

DIVIDENDS, 364; Balance Sheet and, 364; Bankruptcy and, 698; Bonus Shares as, 378; Book Entries of, 369, 376; Book or Sheets, 376; Calls in arrear and, 364; Coupons, 397; *Cum div.*, 375; Defined, 364; *Ex div.*, 375; Forms, Example of, 377; Goodwill and, 93; Income Tax on, 372; Interim, 368; On bearer securities, 378; Payment of, direct to Banker, 375; Payment of, out of Profits, 365; Preference, arrears of, 367; Reserve Account, 378; Scrip, 373; Sheet, example of, 376; Stale and Lost Warrants, 377; Treatment of, paid, 34; Unclaimed, 370; Unclaimed Interest, 399; Warrants, 374

DIVIDEND WARRANTS, 374

DOUBLE ACCOUNT SYSTEM, 80

Dovey v. *Cory* [1901], 365

Eighth Schedule (*Companies Act*, 1948), Balance Sheet and, 80, 82, 83; Secret Reserves, 65

Elliot v. *Elliott* [1911], 216

ENDOWMENT POLICY ACCOUNT, Specimen of, 46, 54

England v. *Curling* [1844], 123

ENTRANCE FEES AND SUBSCRIPTIONS, Treatment of, 37

EQUITY SHARE CAPITAL, 527

ESTOPPEL, 126

Ex. div., 375

EXECUTOR, Liability for shares, 335

EXEMPT PRIVATE COMPANY, Defined, 269; Privileges of, 268, 269; Conditions to be complied with, 269

EXTRAORDINARY GENERAL MEETING, 342

EXTRAORDINARY RESOLUTION, 343

FACTORS STOCK BOOK, 20, 22

FINANCIAL EXPENSES, treatment of, 35

FIRM NAME, 121

FIRM NOT A SEPARATE ENTITY IN ENGLAND, 122
FIXED ASSETS, 87; presentation of in Balance Sheet, 94–97; fluctuation in value of, 40
FLOATING ASSETS, see under *Current Assets*
FLUCTUATING EXCHANGE, 631
FLUCTUATION IN VALUE OF FIXED ASSETS, 40
FORGED TRANSFER, 341
FOREIGN BRANCH ACCOUNTS, 624; Book-keeping methods and, 625; Book-keeping by Branch, 627; Conversion of Foreign Branch, 627; Fluctuating Exchange and, 626; Foreign Branch Ledger at Head Office, 629; Remittance Account, 627; Rules for Conversion, 628; Stable Exchange and, 625
Foreign Interests Act (1917), 256
FORFEITED SHARES AND BALANCE SHEET, 103; See also under *Shares*
FORWARD INVOICES, treatment of, 21
FREEHOLD LAND AND BUILDINGS, valuation of, 89
FURNITURE, FIXTURES AND FITTINGS, valuation of, 99

Gambling Act, 1774, 731
Garner v. *Murray* [1904], 212; Procedure following, 213
General Auction Estate Co. v. *Smith* [1891], 309
Goldjarb v. *Bartlett* [1920], 134
GOLDSMITH'S BOOK, 754
GOODS IN TRANSIT, Treatment of, 23
GOODS ON APPROVAL, 17
GOODS ON CONSIGNMENT, 17
GOODWILL, Balance Sheet, treatment on, 88; Partnership and, 135, 161, 166, 172; Purchase, value of, 86; Purchase of Business, 440, 473; Price of shares and, 357; Provision for reduction of, 82; Valuation of, 91; writing down of, and Articles, 86
GOVERNMENT STOCK, 307
GROSS PROFIT, Ascertainment of, 12; Departmental accounts and, 582; Increases in, 16; Trading or Manufacturing Accounts and, 13
GROUND RENT, Treatment of, 31
GUARANTEE COMPANY, 262; Must have Articles, 273
GUARANTEED STOCK, 307

Harman v. *Johnson* [1853], 127
Hawksley v. *Outram* [1892], 120
Henry Jameson deceased, Re, Attorney-General v. *Jameson and others* [1905], 486
HIRE-PURCHASE, 671; Analysis of the Purchase price, 672; Payment by Instalment, Method of, 672; Purchases for Deferred Payments by Instalments, 672; Sales for Deferred Payments by Instalments, 684; Treatment in Books of Account, 672
HOLDER FOR VALUE, Banker as, 756
HOLDER IN DUE COURSE, 779
HOLDING COMPANY, 464; see also *Consolidated Accounts*
Holt v. *Markham* [1923], 746
HOSPITAL INCOME AND EXPENDITURE ACCOUNTS, 76

INCOME ACCRUED, Treatment of, 35
INCOME AND EXPENDITURE ACCOUNT, 72; Compulsory, 24; Difference between, and Receipts and Payments account, 73; General Meeting and, 72
INCREASE OF CAPITAL (COMPANY), 421
INDEX OF MEMBERS, 321
INSCRIBED STOCK, 307
INSOLVENCY, see under *Bankruptcy* and *Deeds of Arrangement*
INSPECTION (COMPANY), 345
INSPECTION OF REGISTERS (COMPANY), 321
INSURABLE INTEREST, 731
INSURANCE, distinguished from Assurance, 729; Kinds of, 730; Non-tariff Offices, 730; Tariff Offices, 730

INSURANCE POLICY METHOD OF DISTRIBUTING DEPRECIATION, 45

INSURANCE PREMIUMS, Treatment of, 33

INTEREST, Accrued, treatment of, 100; On Capital (Partnership), 32, 149; On Drawings (Partnership), 32, 150; On Loans and Debentures, treatment of, 32; Paid out of capital, 419; Received, treatment of, 32; Trade, treatment of, 32

INVESTMENTS, 87; Ledger for, 99; Profit on Sale of, treatment of, 36; Quoted, 87; Reserve Fund and, 100; Trade, 87; Unquoted, 87; Valuation of, 99

INVOICES (FORWARD), 21

IRREDEEMABLE (PERPETUAL) DEBENTURES, 310

ISSUED CAPITAL, 300

ISSUE OF SHARES AT A DISCOUNT, 306

ISSUING HOUSE, 284

Johnson v. *Lyttles' Iron Agency* [1877], 384

JOINT VENTURES, Book-keeping treatment of, 251; Defined, 251; Rules for accounts in, 252; When special treatment is required, 252

Kendall v. *Hamilton* [1879], 127

Kingston Cotton Mill Co. Ltd. [1896], 286, 288

Lagunas Nitrate Co. v. *Lagunas Nitrate Syndicate* [1899], 282

Lagunas Nitrate Co. v *Schroeder* [1901], 368

LAND AND BUILDINGS, Valuation of, 89

LAW MERCHANT THE, Defined, 748

LEASE ACCOUNT, 58

LEASEHOLDS, Valuation of, 89

LEASE, Treatment of premium on, 89

LEASES AND SINKING FUND, 56

Lee v. *Neuchatel Asphalte Co., Ltd.* [1889], 52, 100

LIABILITIES, Contingent, treatment of, 61; In Balance Sheet, 103

LIEN (BANKER'S), 760

LIFE ASSURANCE, see under *Assurance*

LIFE POLICIES, Assignment of, 732, 733; Mortgage of, how affected, 733

LIMITED COMPANIES, Absorption of, 467, 471; Age limit of Directors, 281; Agenda Book, 319; Allotment Letters and, 291; Return of Allotments, 290; Register of Allotments Returns, 320; Register of Allotment Sheets, 320; Amalgamation of, 464, 471; Annual Meeting, 342; Annual Report and Accounts of, 486; Annual Return, 324; Appointment of Directors, 281; Assets of unrealisable value in, 87; Articles of Association of, 265, 272, 273, see also under *Articles of Association*; Variation of articles of, 271; Auditors and, 286, see also under *Auditor*; Balancing Share Register of, 420; Balance Tickets and, 340; Blank Transfer and, 340; Borrowing powers of, 309; Brokerage and, 285; Calls and, 291, 361, see also under *Calls*; Calls in advance and arrears and, 298; Call Book and 320; Capital of, 300–305; Capital, increase of, 421; Capital, reduction of, 421, see also under *Capital*; Certification and, 341; Register of Certificates and Balance Tickets and, 320; Common Seal of, 283; Company meetings and, 342; Consolidated Accounts of, 526, see also under *Consolidated Accounts*; Contrasted with Firm, 263; Conversion of Business into, 473; Conversion of shares of, into stock, 418; Current assets and, 87; Debentures, see under *Debentures*; Debenture Interest Books, 320; Debenture Holders of, Register of, 320, 333, 334; Debenture Stock Holders, Register of, and, 320, 334; Debenture Transfers and 341; Defined, 261; Directors and, 281, see also under *Directors*; Directors' Attendance Book, 320; Directors, liability of, 281; Directors, loans of, 87; Directors, report of, 366, 487; Directors and Secretary of, register of, 331; Dissentient Shareholders of, 471; Dividends of, 364; Dividend Book of, 320, see also under *Dividends*; Documents to be filed with Register, 320; Exempt Private, 269; Extraordinary General Meeting of, 343; Extraordinary resolution of, 343; Financial assistance by, for purchase of its own shares, 300; Fixed Assets and, 87; Forged Transfer and, 341; Formation of, 265; Guarantee, limited by, 262; Holding, see under *Con-*

solidated Accounts; incorporation of, methods of, 261; Index of Members of, 321; Inspection of, 345; Inspection of Registers of, 321; Interim Dividends, 368; Interest on shares of paid out of capital, 419; Kinds of, 262; Letter of regret and, 290; Losses of, prior to incorporation, 482; Members of, register of, 321; Memorandum of Association of, 265, 270, 271, see also under *Memorandum*; Meetings of, see under *Meetings*; Minimum Subscription, 266; Minute Books of, 330; Mortgages and Charges of, register of, 331; Non-statutory books of, 319; Opening entries in books of, 350, 351, 352; Ordinary Resolutions of, 343; Parliamentary, 261, 265; Poll and, 344; Posting Share Register of, 321; Powers and Duties of Directors of, 281; Powers of Attorney of, register of, 320; Preference Dividend of, arrears of, 367; Preliminary Contracts and, 279; Preliminary Expenses and, 279, 415; Shares of, at Premium, issue of, 357, 358; Private, 267; Probates Register of, 320, 334; Procedure to record purchase of business by, 440; Profit and Loss Account and Balance Sheet of, 487; Profits of, prior to incorporation, 482; Promoter and, 279; Prospectus and, 266, 274, 275, 276, 277, see also under *Prospectus*; Proxies and, 345; Purchase of Business and, 440; Quorum and, 345; Quoted Investments and, 87; Reconstruction of, 453, 454, 455, 471; Register of, closing of, 375; Registration of, 262; Resolutions of, 343; Resolutions of, requiring special notice, 344; Return of Capital to Shareholders, 432; Seal of, for use abroad, 284; Sealed Documents of, Register of, 335; Sealed Documents, register of, 320; Secretary of, and, 289; Share Certificates and, 299, see also under *Shares*; Share Certificates, register of, 320; Shares of, at a Discount, issue of, 358; Share and Stock, Transfers of, 335; Share Warrants and, 300; Shareholders rights and, 272; Special Resolution, 343; Splitting shares of, 416; Statement in lieu of Prospectus and, 266, 278, 279; Statutory, 261, 265; Statutory Books and Documents, 318; Statutory Meeting, 342; Statutory Report of, 412; Stock of, Register of, 320, see also under *Stock*; Stock Exchange Quotation and, 315; Stockholders of, Register of, 320–332, 334; Subscription list and, 289; Trade Investments and, 87; Transfer Fees, Book of, 337; Transfer Fees of, Cash Book, 320; Transfer, form of, 337, 338; Transfer, liability of parties to, 339; Transfers, register of, 320, 335, 336; Transfers, Scrutiny of, 339; Transfer Stamp Duties and, 337; Ultra vires acts and, 284; Underwriting and, 284; Unlimited liability and, 262; Unquoted Investments, 87; Valuation of Shares of, 484; Vendor and, 280; Voting and, 345

LIMITED PARTNERSHIP, 137, 138, 219–220; Accounts of, 221; Dissolution of, 220; General Partners in, 220; Loans, treatment of, 222; Registration of, 219; Rights of Limited Partners in, 220; Winding up of, 221

Limited Partnership Act, 1907, 219

Limited Partnership Rules, 219

Lindley, J., On mines, 100; On Transfers, 335

LIQUIDATED DAMAGES, 760; Defined, 777

LOAN CAPITAL, 300

LOANS, Balance Sheet and, 101; Financial assistance by company for purchase of its own shares, 300; Interest on, treatment of, 32, 148; Life Policy, as security for, 417

Lock v. *Queensland Investments and Land Mortgage Co.* [1896], 361

LOCKER CARDS, 644

London and General Bank [1895], 286, 365

LONG BILLS, 756

LOOSE TOOLS, Valuation of, 89

LOSSES (PAST) AND PAYMENT OF DIVIDENDS, 66

LTD. (Ld.), Use of abbreviation apparently legal, 271; When may be dispensed with, 271

Lucas v. *Fitzgerald* (1905), 368

MACHINERY AND PLANT, Treatment of, in Balance Sheet, 93; Valuation of, 93

MACHINERY REPAIRS, Treatment of, 30

MANAGING DIRECTOR, 283; Commission of, treatment of, 33; see also under *Director*

MANUFACTURING ACCOUNT, 12–23; Carriage and, 30; Construction, 14, 15;

Divergence in form of, 14, 15; Factory manager's salary and, 28; Machinery Repairs and, 29; Royalties and, 31; Specimens of, 14, 15; Trade Expenses and, 31

Mead v. *Ball, Baker & Co.*, 288

MEETINGS (COMPANY), 342; Annual General, 342; Creditors, 453; Extraordinary General, 343; Poll at, 344; Table A and, 344; Proxies at, 345; Quorum at, 345; Resolutions at, 344; Special Business at, 342; Statutory, 342

MEMBERS, Register of (Company), 319

MEMORANDUM OF ASSOCIATION, 265, 320; Alterations in, 272; Borrowing powers and, 309; In what way binding, 271; limited in, 270; Name of company and, 270; Objects of Company and, 271; Registered Office and, 270, 271; Share Capital and, 271; Subscribers to, 270

MEMORANDUM OF SATISFACTION, 334

Metropolitan Coal Consumers' Association v. *Scrimgeour* [1895], 285

MINES AND QUARRIES, Wasting nature of, 100; Royalties and, 686, 687

MINIMUM (DEAD OR FIXED) RENT, 687

MINIMUM SUBSCRIPTION, 266

MINUTE BOOKS, 319, 330

MORTALITY TABLES, 730

MORTGAGES, Assignment of Life Policy, by way of, 732; Definition of, 342

MORTGAGES AND CHARGES, REGISTER OF, 331, 332

MORTGAGE DEBENTURES, 310

Mosely v. *Koffyfontein Mines* (1904), 392

MULTIPLE SHOP CONCERNS, 603; Branch Supplies journal specimen of, 606; Cash Sales and, 604; Check System and, 604; Depreciation of Assets how charged, 607; Final accounts in, 607; Method of Accounting and, 604; Stock Requisition, 605; Warehouse Expenses, 607; Weekly Return, 605

NEGOTIABLE INSTRUMENTS, 763–792; Examples of, 768; Share Warrants as, 300

Nell v. *Longbottom* [1894], 345

NET PROFIT, Ascertainment of, 23; Defined, 13

NET PROFIT ACCOUNT, see under *Appropriation Account*

NET REVENUE ACCOUNT, see under *Appropriation Account*

Newton v. *Birmingham Small Arms Co. Ltd.* [1906], 288

NON-CUMULATIVE PREFERENCE SHARES, 303

NOTES (COMPANY), 315

NOTICE IN LIEU OF DISTRINGAS, 390

NOTING A BILL, 777

"NOT NEGOTIABLE", 784, 785, 786

"NOT SUFFICIENT", 784

"OFFER FOR SALE", 284

OFFICIAL RECEIVER, 692, 693, 694, 696

OFFICIAL SEAL FOR USE ABROAD, 284

ON APPRO., 17; Treatment of, 21

ONCOST, 655, 656, 657, 658, 659, 660

Ooregum Gold Mining Co. v. *Roper* [1892], 357

OPENING ENTRIES (COMPANY), 350, 351, 352

ORDINARY RESOLUTION, 343

ORDINARY SHARES, 304

OVERRIDING COMMISSION, 285

PACKAGE STOCK ACCOUNT, Treatment of cost of packing materials purchased, 22; Specimen of, 19

PACKAGE TRADING ACCOUNT, Specimen of, 20

PACKING MATERIALS, Treatment of, 21

PAID-UP CAPITAL, 300

PARLIAMENTARY COMPANIES, 261, 265

PARTICIPATING PREFERENCE SHARES, 303

PARTNERSHIP, Accounts, 142; Acts that govern, 119; Agreement, 123, 133; Amalgamation, guarantees on, 171; Amalgamation of two businesses and, 179; Annuities and, 182; Assets, revaluation of, in, 176, 193; Assignment of share in, 131, 132; Capital and Current accounts in, 142; Cessation of business and sale of assets in, 183; Consequences of Dissolution, 134, 135; Contents of Agreement, 123; Contrasted with Limited Company, 263; Deceased Partner and, 137; Defined, 119; Determination of, 131; Disputes in, 130; Dissolution by Arbitrator, 134; Dissolution of, 132, 133, 134, 135, 182, 183, 184, 189, 193, 201; Dissolution in limited partnership, 220; Dissolution of, loss on, 203; Dissolution, periodical payments during, 215; Distribution of Assets in Specie of, 193; Division of Assets in, 191; Drawings, method of recording in, 143–45; *Elliott* v. *Elliott* and, 216–18; Enforcing judgment against, 127; Expiration of, 131; Firm name, 121; *Garner* v. *Murray* and, 212–13; Goodwill and, 135, 161, 166, 172; Holding out and, 127; Incoming partner, liability of, 128; Infant in, 122; Insolvency in, 700; Interest on Capital of, 149; Interest on Drawings from, 150; Interest in lieu of Profits and, 203; Joint ownership of property and, 120; Judgment debt against a partner and, 132; Liability of members of, 126; Liability for wrongs in, 127; Limited, 137, see also under *Limited Partnership*; Limited partners and, 219, 220; Limited Partners, rights of, 220; Loans (Partners) in, 148, 174, 222; Losses in, 154; must be legal, 122; New Partner, admission in, 162; New Partner and re-valuation of assets in, 176; Outgoing Partner, liability of, 128; Premium for admission of new partner in, 163; Property and, 132; Realisation Account and, 190, 192, 195; Realisation, loss on, 210, 212; Registration of Business Names in, 115; Relations of Partners in, 128; (to outsiders), 124; Remuneration of Partners in, 130; Rescission of agreement, 133; Revaluation of Assets in, 193; Rights and Duties in, *inter se*, 129; Salaries in, 151; Sleeping partner and, 149, 223; Share of profits borne by other partners in, 158; Survivorship Assurance policies and, 174; *Uberrimæ fidei* and, 130; What creates a, 120, 121; What is not a, 120, 121; Winding up of a, 135, 223

Partnership Act, 1890, 119

PAST LOSSES, Treatment of, in accounts, 66

Patent File Co., Re [1871], 309

PATENTS, Valuation of, 97

PAYMENT BY INSTALMENT, see under *Hire Purchase Accounts*

PLANT LEDGER, Specimen of, 98

POLL, 344

POSTING SHARE REGISTER, 321

POWERS OF ATTORNEY, 320

PREFERENCE SHARES, 302

PREFERRED ORDINARY SHARES, 303

PREFERRED STOCK, 307

PRE-INCORPORATION LOSSES, 484

PRE-INCORPORATION PROFITS, 482

PRELIMINARY EXPENSES, 279, 415; Treatment of, 33

PREMIUMS OF SALE OF INVESTMENT, Treatment of, 36

PREPARATION OF ACCOUNTS IN EXAMINATION WORK, 105–11

PRE-PREFERENCE SHARES, 303

PRIVATE COMPANY, 267; Must have Articles, 273; Advantages and exemptions of, 268; Balance Sheet of, right to receive, 268; Ceasing to be, 268; Conditions to be complied with by, 267, 268; Defined, 267; Joint holders of shares in, 268; Must have Articles, 267, 268; Table A and, 273

PROBATES, REGISTER OF, 320, 334

PROFIT AND LOSS ACCOUNT, Advertising and, 33; Aim of, 23, 24; Apprentice's Premiums and, 36; Capital and Revenue and, 37; Carriage Outwards and, 25; Commission and, 33; Deferred Revenue Expenditure and, 35; Departmental, 582; Depreciation and, 40; Directors' Fees and, 28; Discount and, 33; Dividends paid and, 34; Entrance Fees and Subscriptions and, 37; Examination errors in preparing, 25, 26; Financial Expenses and, 35; Income accrued and, 35; Insurance and, 33; Interest on Loans and Debentures and, 32; Machinery Repairs and, 30; Preliminary Expenses and, 34; Premiums on issue of shares and, 36; Profit on Sale of Investments and, 36; Renewals and, 28; Rent, Rates, and Taxes and, 30; Return and, 30;

Royalties and, 31; Stationery, Stamps, etc., in hand and, 32; Stock in Trade and, 23; Trade Expenses and, 31; Trade Interest and, 32; Transfer Fees and, 36; Wages and, 27; Salaries and, 28
PROFIT AND LOSS ACCOUNT (COMPANY), 487; Appropriation, 492; necessity for exactitude comparative, 496
PROFIT ON SALE OF INVESTMENT, Treatment of, 36
PRO-FORMA INVOICE, 245
PROMOTER, 279
PROSPECTUS (COMPANY), 266; Defined, 274; Goodwill and, 92; Liability under, 274, 275; Statutory requirements, 275, 276, 277
PROVISION, For Bad Debts, 62; Companies' Act definition of, 60; Contrasted with Reserves, 59; Defined, 59; As defined in the Eighth Schedule, C. A. 1948, 85; For Discounts, 64; Limited Companies and, 47; Treatment in accounts, 60
PROXIES, 345
PUBLIC COMPANY, Deferred, 267
PURCHASING OF OWN SHARES BY COMPANY, 300

QUARRIES, wasting nature of, 100
QUICK ASSETS, see *Current Assets*
QUORUM, 345

Rance's Case, 365
RATES, Treatment of, 30
Rayner & Co. v. *Rhodes* [1926], 220
RECEIPTS AND PAYMENTS ACCOUNT, 71; Difference between and Income and Expenditure account, 73
RECEIVING ORDER, 692, 693, 694, 696
RECONSTRUCTION, 453, 454, 455, 471
REDEEMABLE PREFERENCE SHARES, 57, 304; Redemption of, 390
"REFER TO DRAWER", 269
Registration of Business Names Act, 121
REGISTER (COMPANY), Closing of, 375
REGISTER OF MEMBERS (COMPANY), 321; Illustration of, 323
REGRET, LETTER OF, 290, 295
RENEWALS AND REPAIRS, Treatment of, 28
RENT, RATES AND TAXES, Treatment of, 30, 31
REPAIRS AND RENEWALS FUND, 62
Republic of Bolivia Exploration Syndicate Ltd., 288
RESERVE, Defined, 59; Capital, 65; Contrasted with provisions, 59; As defined by Eighth Schedule of the C. A. 1948, 85; Depreciation, 63; Dividend Equalisation 63; Fund or Account, 61; Legal position regarding, 61; Repairs and Renewals, 62; Secret, 65; Treatment in accounts, 60, 105
RESERVE FUND OR ACCOUNT, 62
RESERVE LIABILITY, 300
RESOLUTION, COMPANY, Types of, 343; Requiring special notice, 344
RETURNS, Treatment of, 30
REVENUE ACCOUNTS, 77
REVENUE EXPENDITURE, Defined, 27; Differentiated from Capital Expenditure, 27, 28; In suspense, 39
ROYALTIES, 31; Accounts of, 686; Defined, 686; Development Expenditure and, 686; Minimum Rent and, 687; Mining and, 687; Short-working and, 687; Surface Compensation and, 687; Wayleaves and, 687
Russel, I., On Goodwill, 93

SALARIES, Treatment of, 28
SALE OR RETURN, 17
SALES BOOK, 1
SALES LEDGER, 9
SALES ON APPRO JOURNAL, 19
"SANS RECOURS", 781
SCRIP DIVIDENDS, 373

SEALED DOCUMENTS, REGISTER OF, 320, 335
SECRET RESERVES, 65
SECRETARY, Appointment of, 259; Duties of, 259; Statutory Office of, 259
SECRETARY, PARTICULARS OF, Illustration of, 327
SECURITIES RECEIVED, REGISTER OF, 759
SELF-BALANCING LEDGERS, Defined, 7; Construction of Control Account in, 9; Transfer journal in, 8; Typical set of Books in, 4
Severn and Wye Railway Co., in Re [1896], 365
SHARE CAPITAL AND DEBENTURES, SUMMARY OF, Illustration of, 326
SHARE CERTIFICATE BOOK, ~~Specimen of~~, 299
SHARE CERTIFICATES, REGISTER OF, 320
SHARE AND STOCK TRANSFERS, 335
SHARE WARRANTS, 300
SHARES, Bonus, 305; Bonus as dividend, 379; Book of, 299; Calls on, 361, see also *Calls*; Calls in advance, interest on, 361; Calls in arrear, interest on, 363; Certificates, 299; Convertible Preference, 303; Co-partnership, 305; Cumulative Preference, 303; Deferred, Management and Founders', 304; At discount, issue of, 358; Dissentient Shareholders and, 471; Forfeiture and Re-issue of, 383, 385; Interest paid out of capital, 419; Issue at Discount, 306; Lien and Charges on, 359; Numbering of, 300; Ordinary, 304; Participating Preference, 303; Pre-preference, 303; Preference, 302; Preferred ordinary, 303; At a premium, issue of, 357, 358; Redeemable Preference, 304; Redemption of Redeemable Preference, 309; Re-issued at Premium, 387; Register of, balancing of, 420; Simple or Non-Cumulative Preference, 303; Surrender of, 389; Valuation of, 484; Valuing unquoted, 485; Warrants, 299
SHORTWORKING ACCOUNTS, 687
SIMPLE DEBENTURES, 310
SIMPLE OR NON-CUMULATIVE PREFERENCE SHARES, 303
SINGLE ENTRY, Ascertaining profits under, 1; Conversion into Double Entry, 23; Defined, 1; Statement of Affairs in, 3
SINKING FUNDS, 54; Contrasted, 57; Data for amount of instalments, 55; Deficiency or surplus on realisation of, 59; Defined, 55; For redemption of debentures, 57; How built up, 55; Uses of, 56
SINKING FUND ACCOUNT, 58; Illustration of, 408
SINKING FUND INVESTMENT ACCOUNT, 58; Illustration of, 409
SINKING FUND METHOD OF DISTRIBUTING DEPRECIATION, 42
Skring v. Greenwood [1825], 746
SLEEPING PARTNER, 149, 223; Defined, 125
SPECIAL MANAGER, 696
SPECIAL NOTICE, Resolution requiring, 344
SPECIAL RESOLUTION, 343
SPLITTING SHARES, 416
Stapley v. Read [1924], 66, 92
STATEMENT OF AFFAIRS, In bankruptcy, 693; In single entry, 3
STATEMENT IN LIEU OF PROSPECTUS, 266; Goodwill and, 92; Requirements of, 278, 279
STATUTORY COMPANY, 261, 265, 342
STATUTORY MEETING, 413
STATUTORY REPORT, 412, 413; Illustration of, 414, 415; Information contained in, 413
STOCK, Certificate of, 308; Deferred, 307; Government, 307; Guaranteed, 307; Inscribed, 307; Preferred, 307
STOCK EXCHANGE QUOTATION, 315
STOCK, REGISTER OF, 320, 334; Specimen of, 332
STOCK IN TRADE, Valuation of, 22, 23, 101; Valuation of, for B S, 88
STORE-KEEPING, 643; Bin cards and, 644; Efficient system of, 643; Incoming goods and, 643; Issue of goods from store, 647; Methods of arriving at values for entries, 651; Receipt of goods into Stores, 645; Records essential, 643; Stock-taking, 652; Stores Ledger and, 650
STORES LEDGER, Illustrated, 648
STRAIGHT-LINE METHOD OF DISTRIBUTING DEPRECIATION, 42

Subscribed Capital, 300
Subscription List, 289
Subsidiary Company, 464, see also under *Consolidated Accounts*
Sundry Creditors, Treatment of, in B S, 105
Sundry Debtors, Treatment of, in B S, 101, 102
Survivorship Assurance Policies, 174
Sykes Case, 1872, 298

Table A, 273; see also under *Limited Company*
Taylor, Phillips and Rickard's Case [1897], 335
Tax Reserve Certificates, 87
Tender of Debenture Stock, Specimen of, 404
" Terrier " (Plan of Estate and Rent Register), 30
Timber Trade, Valuation of Stock in, 22
Tools, Loose, see under *Loose Tools*
Total Accounts, see under *Self-balancing Ledgers*
Trade Discount, Treatment of, 23
Trade Expenses, Treatment of, 31
Trade Marks, Patterns, Dies, Drawings, Valuation of, 97
Trading Account, 12–23; Construction of, 13; Departmental, specimen of, 16; Goods on approval and, 17; Goods on consignment and, 17; Packing Materials and, 21; Percentage, specimen of, 16; Specimen of, 14, 15; Stock in Trade, and, 23; Wages and Salaries and, 22
Transfer Fees, Treatment of, 36
Transfer, Form of, 337, 338; Liability of Parties to, 339; Scrutiny of, 339; Stamp Duties on, 337; Transfer Fees Book, 337
Transfer Journal and Self-Balancing Ledgers, 8
Transfers, Register of, 320, 335; Specimen of, 336
Transfers, Stamp Duty on, 473
Trevor v. *Whitworth* [1888], 357
Trial Balance, Trading Account and Profit and Loss Account items in, 25
Trustee, Partners as, 127
Trustee in Bankruptcy, 713; Appointment of, 713; Duties of, 713; Powers of, 713; Remuneration of, 713; see also under *Bankruptcy*
Trustees in Deeds of Arrangement, 722
Trusts, Notice of and Limited Company, 322

Uberrimæ fidei, assurance and, 729
Uncalled Capital Account, 300
Unclaimed Dividends, 370
Underwriting, 284; overriding commission and, 285; sub-underwriting, 285; Commission and, 284
Unlimited Liability Company, 262; must have articles, 273

Valuation Method of Determining Depreciation, 47
Valuation of Assets, 87
Valuation Premium (Assurance), 734
Variation of Shareholders' Rights, 272
Vendor, 280
Voting, 345

Wages and Salaries, treatment of, 22, 28
Waste, 40; Provision for, Legal and Commercial Views on, 47
Wayleaves, 687
Weston's Case, 335
Wilmer v. *McNamara*, 92
Winding-up (Partnership), 135; (Limited Partnership), 223
Wine Trade, Valuation of Stock in, 22
Work in Progress, Valuation of, 23; treatment of, 101
Working Capital, 300
Workmen's Compensation (1923), 695

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